TAX BARRIERS TO TRADE

By

Mark Eisner
Robert L. Cochran
Edgar L. Burtis
Chester H. Gray
L. W. Horning
Floyd D. Strong
John V. Lawrence
J. Wilner Sundelson
Ernest M. Wright
Charles H. Janssen
C. S. Logsdon
Thomas S. Green, Jr.
Ralph E. Curtiss
Maurice W. Lee
A. R. Kaiser
Theodore Christianson
Carl T. Arlt
Neil H. Jacoby
Lawrence Leslie Waters
Mitchell B. Carroll
Eldon P. King
Charles R. Carroll
Henry B. Fernald
Paul Deperon
Robert C. Brown
Hubert R. Gallagher
Reynold E. Carlson
Paul T. Truitt
F. Eugene Melder

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FOREWORD

Each year some tax topic of national and current importance is selected by the Advisory Council of the Tax Institute (formerly the Tax Policy League) for the subject of a two-day symposium. A carefully selected program committee works out a well-rounded and stimulating series of discussions relating to the general topic, and speakers are selected who have given serious thought to the subject. Through the conduct of these symposia, and the subsequent publication of the addresses with index and bibliography, the Tax Institute hopes to make a real contribution to the solution of current tax problems. The focusing of attention upon a problem is a first and vital step toward its solution.

The topic selected for the 1940 symposium was "Tax Barriers to Trade." The Program Committee consisted of Mark Eisner, Chairman, Frank Bane, Mitchell B. Carroll, Marion K. Folsom, and Carl Shoup. Harold S. Buttenheim and Mabel L. Walker were *ex officio* members.

Speakers of divergent points of view were purposely placed on the program. The ideas expressed do not necessarily represent those of the Program Committee. The objective of the Committee was to offer a well-rounded presentation of the problem, so that interested citizens could appraise for themselves the elements of the situation. In every case an effort was made to secure a speaker who could ably present the views of which he was an exponent, whether those views reflected the impartiality of the academic theorist or the self-interest of a particular group.

The Tax Institute expresses its deep appreciation of the cooperation received from the speakers, the Program Committee, and the Committee on Local Arrangements, of which Simeon E. Leland was chairman. Particularly helpful cooperation in connection with the local arrangements was received from H. Gordon Bollman, Chief, Administrative Service Division, Cook County Assessor; Leverett S. Lyon, Chief Executive Officer, Chicago Association of Commerce; and Charles K. Schwartz, formerly Chairman, Illinois Tax Commission. Thanks are due also to Geneva Seybold for assistance in editing the volume and preparing the bibliography.

The Tax Policy League became a part of the Wharton School of Finance and Commerce of the University of Pennsylvania on October 24, 1940. At the time of affiliation the name was changed to Tax Institute. A grant from the Alfred P. Sloan Foundation has enabled the organization to carry on and expand its activities.

MABEL L. WALKER,
Director,
Tax Institute

PART ONE

THE MENACE OF TAX BARRIERS TO TRADE

CHAPTER I

INTRODUCTION TO SYMPOSIUM

MARK EISNER

Member of the New York Bar; and Chairman, Symposium Program Committee

THERE has been much talk in recent months by certain elements in our population about "the wave of the future." These persons seem to be convinced that this so-called "wave" is approaching our shores from outside our hemisphere. They believe that it has already originated in the troubled waters of foreign lands and that it is inexorably bound to engulf us.

I am persuaded that all this talk about "the wave of the future" is another manifestation of the antediluvian fear of the unknown. Such talk also reveals an appalling ignorance of the currents of American social, economic, and political growth and development.

The future of America may come in waves, or in floods, or just in spurts—but who can say, with reason, that our future must come from abroad? Why must our future derive from the old world? For more than four hundred years we have been building our own future here, progressively freeing ourselves from the European way. For more than one hundred and fifty years of this time we have been pursuing original and independent development of a new way of life for ourselves and our posterity. Why cannot the "wave of the future" come from here, from the hallowed ideas and ideals which have been made in America? Have

not we already wrought a pattern for a better future for all the world right here upon this American soil?

Unhindered by restrictions to free movement, American genius has converted the abundant natural resources of this continent to useful and highly desirable purposes. The buttress for this continuing process of free interchange is our Constitution. While guarding our personal liberties from encroachment by government, our Constitution freed us to develop our social life and our economic life to the very limits of their possibilities. Thus we established in the United States the largest single free-trade area. Professor F. Eugene Melder stated last March that the "internal market in the United States was the largest free market in the world, until recently."

Interstate Trade Barriers

It is most significant that Dr. Melder adds "until recently" to this statement. None of us who has had any business dealings in recent years could have missed noting the increasing accumulation of obstacles to free trade within the boundaries of our country. While our distinguished Secretary of State has busied himself, during the early part of his term in office, with establishing free international markets for our goods on a reciprocal basis, our state, our city, and even our county units of government, have been busily erecting tariff barriers against the free flow of goods and services from one part of our country to the other. Whether intentional or unintentional, laws have been enacted which in effect increase the difficulties of economic intercourse among our people. To serve the temporary or selfish interests of a few politically potent local factors, our national economy has been seriously interfered with. Trade among the various communities has been disastrously

choked off by the use of the spending, taxing and licensing, and the police powers of the state and local governments.

In March of this year the Temporary National Economic Committee conducted hearings on Interstate Trade Barriers. Many administrative departments of our federal government have been carrying on extensive researches in this question. The Works Projects Administration of the Federal Works Agency is engaged in making an invaluable Marketing Laws Survey "of those state laws which, on their face, or in operation and effect, tend to obstruct the marketing of goods in interstate trade."

A. H. Martin, Jr., executive director of this survey, reports that 300 attorneys have been employed to read some "375,000 pages of statutory materials" and have published one trade-barrier study and several volumes entitled *State Anti-Trust Laws, State Price Control Legislation,* and other pertinent studies. They will soon publish other volumes in this general field, including one volume which will deal with "taxes directly affecting the marketing of goods."

In an article which appeared in the *American Bar Association Journal* for April, 1939, Dr. Melder listed the following "leading forms" of discriminatory legislation barring trade, enacted under the taxing and licensing powers of the states:

1. Special taxes and license fees required of corporations for the right to do business within the states.
2. Vendor licensing within municipalities which applies to merchant-truckers, and nonresident canvassers.
3. Discriminatory premium taxes on each insurance company doing business within the state, not having a certain proportion of its assets invested within the state.
4. Special taxes on certain types of merchandising organizations.
5. Special taxes on certain commodities which compete with products made within the state, as, for example, state excise taxes on

oleomargarine in dairy states, and similar taxes on margarine containing "foreign oils" by cottonseed oil and cattle producing states.

6. Taxing "foreign" trucks and buses at excessive rates.

7. Use taxes without "offsets" for sales taxes already paid, applied to goods purchased in other states by residents of states having retail sales taxes.

Undoubtedly some of us here know of other established tax barriers to trade among all the people of our land, not to mention the special private province of the states in the realm of liquor taxes. This province has been set up by the unfortunate interpretation which has been engrafted on the wording of the second section[1] of the Twenty-first Amendment to the Constitution. Originally included in the amendment to permit home rule in the so-called "dry" states, in the exercise of their police powers "the provision has been so construed as to enable 'wet' states to threaten the destruction of out-of-state competition within their borders."[2]

All this tax legislation, as well as all other forms of legislation which restrain trade among the states, is clearly in violation of the spirit of the Commerce Clause of our Constitution. Congress, and Congress only, was deliberately empowered "to regulate commerce . . . among the states." "It may be doubted whether any of the evils proceeding from the feebleness of the federal government contributed more to that great revolution which introduced the present system than the deep and general conviction that commerce ought to be regulated by Congress," said Chief Justice Marshall in *Brown* v. *Maryland*.[3] Because under the Ar-

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[1] "The transportation or importation into any state, territory or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited."

[2] F. Eugene Melder, "Trade Barriers and State Rights," *American Bar Association Journal,* XXV (1939), 307.

[3] 12 Wheat. 419, 446.

ticles of Confederation the states erected ironclad economic barriers among them which militated against their growth, they wrote into our Constitution that "no state shall, without the consent of the Congress, lay any imports or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws."

Recent Judicial Decisions

This clause has been circumvented and its spirit repeatedly violated by tax laws such as Dr. Melder has listed. Private individuals have been too weak to challenge them in the courts. Our Supreme Court has often felt itself powerless to enjoin the localities from interfering with the flow of commodities and services across their borders. In the *McGoldrick* v. *Berwind-White Coal Mining Co.*[4] case of this year, the city of New York was sustained in levying a sales tax on Pennsylvania coal sold in the city. Chief Justice Hughes is in the minority when he holds that "The tax as here applied is open to the same objections as a tariff upon the entrance of the coal into the state of New York, or a state tax upon the privilege of doing an interstate business." At another point in the dissent the Chief Justice writes:

> In confiding to Congress the power to regulate interstate commerce, the aim was to provide a free national market, to pull down and prevent the re-erection of state barriers to the free intercourse between the people of the states. That free intercourse was deemed, and has proved to be, essential to our national economy. It should not be impaired.

There is another interesting case adjudicated this year in which the minority made a most important observation on tax barriers to trade. In *McCarroll* v. *Dixie Greyhound*

[4] 309 U. S. 33, 61, 69.

Lines, Inc.[5] the Court enjoined Arkansas from imposing a tax upon gasoline in excess of 20 gallons carried into the state in buses for use in other states. Justices Frankfurter, Black and Douglas, in their dissent, write:

> This case again illustrates the wisdom of the Founders in placing interstate commerce under the protection of Congress. The present problem is not limited to Arkansas, but is of national moment. Maintenance of open channels of trade between the states was not only of paramount importance when our Constitution was framed; it remains today a complex problem calling for national vigilance and regulation. . . . Diverse and interacting state laws may well have created avoidable hardships . . . But the remedy, if any is called for, we think is within ample reach of Congress.

Possibility of Congressional Action

Congress is urged to take the matter of regulation into its own hands because "Judicial control of national commerce—unlike legislative regulation—must, from inherent limitations of the judicial process, treat the subject by the hit-and-miss method of deciding single local controversies upon evidence and information limited by the narrow rules of litigation." Here again I have quoted from the dissenting opinion of Justices Frankfurter, Black and Douglas. They go on in their dissent to suggest that Congress consider the matter after making "a nation-wide survey of the constantly increasing barriers to trade among the states."

This excellent proposal by three jurists of our high court, and many similar suggestions made by some of the other justices who have been watching from their vantage-point on the bench for two decades the building up of trade barriers, have as yet gone unanswered by Congress. Congress will undoubtedly finally be forced to turn its attention in its own time to this important matter. Symposia such as we are holding here now, may well hasten the day.

[5] 309 U. S. 176, 185, 188, 189.

Perhaps it is not too much to hope that Congress will soon set up a national commission to study the coordination of federal, state, and local taxes. In a message to the National Conference of Real Estate Boards, the President recently referred to such a commission "composed of men of ability, high in public confidence, and familiar with the intricacies of tax law." He indicated rather hopefully that it would be desirable for Congress to establish it. Such a national commission would undoubtedly also have on its agenda the large subject of local and state taxes which interfere with trade.

Congress can hardly be expected to enact hurriedly any comprehensive laws in this wide field. The nation is a highly complex economic entity, and any sudden dislocation by government fiat might result in endless disturbances. Congressional legislation, especially in the realm of license fees and tax barriers to trade, will have to be evolved gradually and with the cooperation of the various taxing units concerned, and other public and private bodies.

Activity of Council of State Governments

Some progress in this direction has already been made, thanks to the Council of State Governments. Commissions on Interstate Cooperation of 44 states have already effected the elimination of some trade barriers, and have successfully resisted the establishment of new ones. The governors of several states have vetoed and have gone on record that "they would veto any further legislation which would operate to impede the free flow of commerce."[6]

In April of last year Chicago was host to a National Conference on Interstate Trade Barriers, sponsored by the

[6] Frank Bane, Executive Director, Council of State Governments, at TNEC Hearing, March 18, 1940.

Council of State Governments. President Roosevelt, in a letter which he addressed on that occasion to Governor Robert L. Cochran, President of the Council, wrote among other things: "Long known as the world's greatest single free-trade area, much of our country's commercial importance has been due to the mobility of trade throughout all the states." The President concluded the letter: "It is my earnest hope that the several states meeting in Chicago will take effective steps toward the removal of all barriers to the free flow of trade within our nation."

The Council of State Governments has been assiduously engaged in achieving this purpose, and has already met with some success. Several committees, consisting of most competent and responsible persons, have set to work to study the problem in its particulars, and to acquaint the public with regard to the general question.

Purpose of Symposium

Obviously, taxes and licensing fees represent one of the most troublesome series of barriers to trade. The Tax Policy League, which is now known as the Tax Institute of the Wharton School of Finance and Commerce of the University of Pennsylvania, since its founding in 1932, has been engaged in "supplying accurate and unbiased tax information on federal, state and local taxes, in a form which can be readily understood by the layman." In keeping with this important purpose, the Tax Institute has organized this symposium on "Tax Barriers to Trade."

We hope by means of this and similar symposia, and our subsequent publications in the field, to contribute to a better understanding of this vast and serious problem which confronts our nation and impedes its economic health. We want by this symposium to help clarify the situation in

order to enable responsible public officials and the public at large to work towards the amicable and satisfactory removal of barriers which divide our nation. For the greater unity of our nation, for its economic health and social well-being, for a better future, and for the welfare of ourselves and future generations of Americans, we have organized this symposium on "Tax Barriers to Trade."

CHAPTER II

THE MENACE OF TAX BARRIERS TO TRADE—INTERCITY, INTERSTATE AND INTERNATIONAL

ROBERT L. COCHRAN

Governor of Nebraska

TRADE barriers between municipalities and between states of this country affect prices, the movement of goods and services between states, the consumption rate of the American public, and the general level of domestic trade. I hesitate even to comment on the results of barriers to international trade. The world spectacle of the moment speaks all too eloquently of the bitterness, animosities, and eventual "total struggle" engendered in no small degree by barriers to trade.

With reference to international trade barriers, we have had more than a century and a half of experience with them. Our people are all too cognizant of them and of their evil effect. With reference to trade barriers between states, however, and between communities within the state, these barriers have grown up during a comparatively brief period. We are less familiar with them because of this brief period of experience and because, too, of their less dramatic effect on our national economy.

The strength of our federal structure lies in national unity. At few times in our history has there been greater need for unity of thought and action between the states than at present. This need exists at all times, but it is emphasized

by our present emergency conditions resulting from the troubled state of international affairs.

Free trade, in principle, was guaranteed by the Constitution and yet to make it effective required definite cooperation between the states. For nearly a century there was an exercise of cooperation between the states to make effective the intent of the framers of our Constitution. It has been a cooperation induced by a division of jurisdictional areas among the states. These two factors have created an interdependence which has welded our nation of many races, geographic extremes, and economic differences into a solid unit which transcends its federal structure. It remained for the present generation to build trade barriers by legislative and administrative methods which have tended to separate the states, thus threatening the national unity contemplated by the framers of our government.

Appearance of Trade Barriers

These barriers made their initial appearance in large numbers in the early thirties. A precise analysis of their causes is not possible, though their advent at the time of the depression offers clues as to the motivations. In general, it can be said that they were intended to protect local producers and distributors from out-of-state competition, and in some instances to raise additional revenue for the state treasuries which were so rapidly being depleted by the increasing demands for relief. These trade barriers are imposed both by statute and administrative regulation, through license fees, excise taxes, and various merchandising and inspection requirements.

A further factor in the development of trade barriers has been the desire of individual groups, whose business was depressed, to secure economic competitive advantage

through legislation. During my three terms as governor I have observed during each legislative session the efforts of economic pressure groups to secure legislation intended to meet their competition with a degree of strangulation rather than meeting that competition with improved service. A realistic view forces us to conclude, I believe, that the best method of attack on the problem of trade barriers created by groups is to demonstrate that their real self-interest will best be served by maintaining free trade and free competition between groups, between states, and localities.

Let us look for a moment at the city and state situation in this country. The mean and petty barriers set up locally to bar the foreigner are most easily effectuated, not alone through the power to tax, but also through an unwelcome use of the police power which every unit of government possesses to protect the health and welfare of the people within its jurisdiction. Of this type are all the inspection barriers used so effectively by administrators to favor the local product or the local citizen, to the detriment of the outsider. These are hard to find and hard to correct, for usually they never appear on the printed page of the statute book or the municipal code. They are effectuated usually through the adoption of policies by administration.

These are trade barriers created by administrative acts. They are just as effective in restriction as those created by legislative acts, and are perhaps more troublesome because they are more obscure and are the result, many times, of arbitrary acts of public officials against individuals who had no advance knowledge of such restrictions. The tax barrier must appear in the state statute or in the city ordinance and is, therefore, subject to greater scrutiny.

We must recognize in considering tax trade barriers that

we are investigating one of the most complicated problems of our economy. In many instances their elimination would necessitate widespread adjustment of our domestic economic structure—and at a time when it must not only hold its own, when the world is dealing it daily blows from the outside, but when it must gear itself to its highest productive capacity for our own defense. Nevertheless, we must recognize that in the last two decades the multiplication of trade-barrier tax laws and regulations has passed beyond the stage of mere curiosa into the socially, economically and politically dangerous realm of local autarchy. Economic dislocation, slack business, widespread unemployment, are the result. By virtue of the trade-barrier movement the principle fundamental to prosperity is now being violated; protectionism turning inward has been invoked by state against state and industry against industry.

In the agricultural field we find farmers interested in the production of a commodity in one state or section raising tax trade barriers against farmers interested in a competitive agricultural commodity produced in another state or section. Every transportation industry—railroads, airlines, and motor vehicle operators—has sought means of harming its competitors by the use of taxation machinery. They have been all too successful. In one state legislature the trucking interests are successful in damaging the railroads; in another the railroads are successful in hamstringing trucking operations. Local insurance companies wangle from state legislatures prohibitive taxation requirements on out-of-state companies. But to obtain a good view of this inward protectionism run wild, we must scrutinize carefully the various liquor tax statutes of the states—and of the municipalities as well. Here the Federal Constitution deliberately leaves the field wide open to state and local taxing bodies.

Effective Efforts to Reverse Trend

It seems to me that, disrupting though the sudden and complete elimination of tax barriers to interstate and intermunicipal trade might be, we can and must continue the effective efforts already begun to stop further encroachments and continue the reversal of this damaging trend. This has been and can be accomplished more effectively through the states than through any other agency. The states have been largely responsible for this condition. The states should bear the responsibility for correcting it. Nor have they shirked this responsibility. First, the governors, at their 1938 meeting in Oklahoma, voiced serious concern over the trend, and departed from a hard and fast precedent by authorizing me, as their chairman, to announce publicly our unanimous condemnation of trade barriers. The Council of State Governments, of which I was then president, shortly thereafter placed this whole problem as "item number one" on its agenda, at the direction of its General Assembly, a meeting representing all the states.

Consequently, in April, 1939, legislative and administrative representatives of 42 states and the federal government met in the city of Chicago at the call of the Council. From that conference came forth a clear-cut and unambiguous statement. "The National Conference on Interstate Trade Barriers declares itself to be unalterably opposed to the erection of discriminatory trade barriers."

This conference merely marked the initial step in the Council's concerted effort to eliminate interstate trade barriers. Since then it has worked for the closer coordination of the activities of all other governmental agencies heading in the same direction. More particularly it has sponsored numerous regional conferences where trade barrier frictions have been removed, has cleared the way for informal nego-

tiations, and in general has bent its efforts toward furthering any amicable solution of such controversies. Now, a year and a half later, it seems certain that the trend has been reversed. Further similar good results will come from this symposium.

Recent Growth of Trade Barriers

The accelerated growth of trade barriers in recent years, while dating from the World War period, began to have important consequences at the end of the new era. During the depression a considerable variety of market-freezing statutes and regulations were enacted.

The "border wars" between states relative to motor vehicle control broke out early in the depression period. Reciprocity agreements, which have been used prominently for the last three years or so, have helped, but without them states required all out-of-state trucks to register, and imposed a burden out of all proportion to the mileage covered or to the amount that the intrastate carrier was required to contribute.

The use by the states of the relatively high ton-mile tax on out-of-state trucks was a new device. In this case extra fees were made contingent upon the granting of reciprocal privileges by the other states concerned. Hardly a session of state legislatures has passed since 1929 without the imposition of heavier burdens.

Another discrimination discovered by the states by which it was possible to hit the out-of-state truck has been the adoption of large fees imposed upon itinerant truckers. For instance, Idaho and Washington impose fees of $300 a year in each county, in addition to a surety deposit of $500 placed with the county treasurer. During the last regular sessions of the majority of state legislatures, held in 1939, itinerant merchant bills were introduced in 22 legislatures.

Use taxes were imposed in many states as a logical accompaniment to state sales taxes, which gained in popularity during the depression years. Their object, of course, was to provide that products from other states should bear the same burden as those sold at home. But in those states where complete fairness was desired, these use tax statutes contained compensatory features. These "compensating clauses" provided that products should be exempted from state sales or use taxes to the extent that they had already shouldered such a burden from the state of origin. This gave these commodities an equal chance with those produced within the state. But again in many instances this compensatory feature was carefully left out of the statutes, in order that home products might enjoy an advantage in the home market. Six states since 1934 have adopted use taxes without the compensatory feature.

Traditional Protectionism

National protectionism has been a tradition with us. We gradually built up tariff barriers to a high point in 1930 with a Smoot-Hawley tariff, and then we had a reversal in national policy with our present reciprocal tariff act of 1934. It looks as though protectionism has turned its head inward and the states and the municipalities are now taking up where the national government left off. The states are sovereign bodies, and when you get "hit" on the notion of the privileges of sovereignty and begin dealing with the problem in a state legislature—where you are responsible for the welfare of only your own citizens—and find that labor is flowing in from other states to curtail the employment privileges of your own citizens, nothing seems more natural to a state legislator than that he should proceed to protect his own people against the people of the adjoining states.

The fallacy involved is due largely to the tremendous expense, climatic variety, and geographical differences of this nation. We must face the fact, however, that citrus fruits, for instance, grow only in our southern states, that the great dairy industry is concentrated in our northern and eastern commonwealth. To aim at economic independence in any one of the 48 states is the great error that the farsighted organizers of this country sought to prevent in 1789.

Trade barriers by taxation or otherwise were by no means unknown before that time. It is hardly too much to say that the barriers erected by taxation between the struggling colonies contributed more than any other single factor to the recognition of the need of union, and—as the founding fathers fondly supposed—control of imports and exports by a central agency utilizing its tariff-levying power only for the benefit of the entire nation.

Collier's Magazine aptly stated the situation in its editorial column last May, when it said:

> It was in the hope of ending brotherly rib-sticking that responsible men of the young nation called the Constitutional Convention of 1787. Eventually they put the Constitution together, and after much argument, sold it to the majority of the states. It became effective in June, 1788. Special reference was made in this immortal (we hope) document to keeping each state's hands off of all the other states' throats, so that all the states might live and prosper.
>
> It was thought that this might settle the matter of interstate bickering and tariff-levying for good and all. The Union victory in the Civil War a few generations later was thought to have re-enforced that settlement of 1787 for time and eternity.
>
> In the present decade, however, the same old stuff has started over again. . . .
>
> One of the simplest and quickest ways to divide this country is to restore petty interstate rivalries, making them official by putting pesky little bureaucrats in uniform at miniature custom houses where main highways cross state lines.
>
> Then, when the Union has come completely undone and we're all battling against ourselves, we'll be rotten-ripe for some strong, united,

and larcenous nation to finish the work of taking 1787 apart by moving in and declaring itself the new boss of all of us or a large carving of us.

During this symposium we will discuss in more detail trade barriers erected through the use of the taxing power in specific fields, and, further, we will look at the steps that are being taken to remedy an already dangerous situation. We will hear discussion of the work which the Governors' Conference, the Council of State Governments and its Commissions on Interstate Cooperation in 44 of the states are undertaking, as well as the splendid cooperation which has been given to the states in these efforts by the federal government in its establishment of the Interdepartmental Committee on Interstate Trade Barriers.

The matter is not one in which we can satisfy ourselves that, like sin, "everybody's against it." It is one which must be specifically threshed out in each of the fields concerned and one in which we must seek to discover, not only the difficulties which these policies may be causing us today and in which we must be certainly alert to prevent the addition of further barriers of this type, but, as well, we must attempt to gauge as accurately as possible, with our present limited knowledge, the effects of the removal of these barriers on the general economic structure of the country and of the individual states concerned. We must, of course, be careful not to weaken this structure at a time when such an enormous strain is thrown upon it. But by the same token, we must find specific means of gradually eliminating these present dangers to the free flow of trade—the lifeblood of a nation. It seems to me that the world example of what happens when self-sufficiency runs wild should be so strong that we should encounter no difficulty in solving our taxing problems of this type when we find reasonable specific methods of dealing with them. This symposium should devote itself to that task.

PART TWO

HIGHWAY TRADE BARRIERS

CHAPTER III

THE FARMER'S CONCERN IN HIGHWAY TRADE BARRIERS

Edgar L. Burtis

Bureau of Agricultural Economics

The topics I propose to discuss are these: (1) What are trade barriers? (2) A classification of highway trade barriers; (3) The farmer's concern in highway trade barriers; and (4) How can highway trade barriers be removed?

Manifestly, it will be impossible to treat these subjects in detail, but this discussion will be served if they are presented in rough outline.

What Are Trade Barriers?

First, then, what are trade barriers?

There is a reason for plunging immediately into a consideration of something as academic as a definition. In the selection of speakers and topics on this program there is an implication that farmers, highway users, and the railroads will differ in their views on highway trade barriers. I submit, on the contrary, that trade barriers, properly defined, are non-controversial; that they are contrary to public policy by the very fact of being trade barriers; and that farmers, highway users, and railroad companies therefore have no choice but to agree on the trade-barrier question.

As I see it, there can be no question, and in reality there is no question, about the undesirability of trade barriers. The controversial issues center, rather, around two other

points. The first is, "What are trade barriers?" Although agreement is possible on the general outlines of a definition of trade barriers, there is often room for argument as to whether a given existing situation should be considered a trade barrier. The second point for argument is, "Will society be better off or worse off if we remove this particular measure, which constitutes a trade barrier or which gives rise to a trade barrier?" Many trade barriers have their source in measures designed to accomplish a socially desirable purpose. An excellent example is sanitary regulation of milk supplies. The debate must then revolve around two further questions. Can other measures be devised to accomplish the same socially desirable objective but at the same time to avoid, partially or wholly, the trade-barrier aspects of the existing measures? If not, then do the good results of the existing measures outweigh the ill effects of the trade-barrier situation incident to them?

I propose now to revert to the first question, "What are trade barriers?" The next few sentences will attempt to define trade barriers for the purposes of this discussion. The rest of the paper will be concerned mainly with identifying particular types of measures as trade barriers or as giving rise to trade barriers, and with considering whether satisfactory systems of highway taxation could be devised that would have less pronounced trade-barrier effects than our present arrangements.

The term "trade barriers" is plain English that can be used to describe a large variety of impediments to trade. The meaning it has in the phrases "interstate trade barriers" and "barriers to internal trade," however, is a special one. In this context it does *not* mean, for example, geographical barriers to trade, such as mountain ranges or unbridged rivers; nor does it denote the natural obstacles to the ex-

pansion of business enterprises, as the difficulties of establishing sales outlets or new business contacts generally. In this context it does not include restrictions on free entry into professions, trades or crafts, or lines of business. Neither does it embrace discouragements or prohibitions of certain types of businesses considered socially undesirable, such as horse racing, lotteries, and gambling establishments; nor restrictions upon the movement of commodities or products considered socially undesirable. Finally, the term "trade barriers," defined for the purposes of our discussion here, most emphatically does not include indiscriminately anything that acts as a drag on the movement or sale of goods. In such a view most taxes would be branded as barriers to trade, and probably no one here intends to criticize all excise taxes because they reduce consumption, or all taxes on transportation agencies because they make transportation costlier. Rather, the purpose is to examine particular taxes to see whether or not they tend to split our national economy into segments—to bar off one section of the country from the other.

For the purposes of our discussion, therefore, trade barriers should be defined as measures that tend to obstruct the exchange of legitimate services between one part of the country and another, or the flow of healthful and honestly described commodities from one part of the country to another. We are concerned here with the trade barriers that obstruct the movement of goods or services across political boundaries or other man-made lines.

Classification of Highway Trade Barriers

Highway trade barriers can be conveniently divided into six classes. Three of these are tax barriers, two are non-tax barriers, and the remaining one is the port of entry.

Let us consider the port of entry first. Ports of entry are dramatic and disconcerting symptoms of the trade-barrier problem, but I am not sure that they should automatically be counted as barriers in themselves. It is true that ports of entry readily lend themselves to the enforcement of trade-barrier laws and regulations. In that case it is the measure being enforced which constitutes the barrier, rather than the port of entry. Repeal of the trade-barrier measure would eliminate the trade-barrier situation at the port of entry.

On the other hand, to the extent that ports of entry cause delay and unnecessary red tape, or if they are administered in a discriminatory manner to the advantage of home-state trucks, they can properly be said to have a trade-barrier effect. But in judging whether a given procedure at a port of entry constitutes a trade barrier, the further question must be answered, whether there is any other administrative procedure to accomplish the same end that would cause less delay and less red tape, annoyance, and expense.

The two non-tax types of barriers are non-uniform state size and weight restrictions and non-uniform safety regulations. Maximum weight limits range all the way from 18,000 to 114,000 pounds, and maximum length limits, all the way from 30 feet to 85 feet. Indeed, in some states there is no limit at all on length. The effect of some of the low maximum limits is to force cargoes destined to points within states having such limits, or to points that must be reached by crossing these states, to be unloaded from larger trucks in general use in neighboring states and reloaded into smaller trucks. This burdens interstate commerce in two ways. The cost of unloading and reloading is a net addition to the cost of carrying the goods in interstate com-

merce, and it usually costs more per hundred pounds to carry the cargo in the smaller trucks.

The problem of non-uniform safety regulations has been greatly ameliorated since the Interstate Commerce Commission prescribed the safety regulations to be observed by the carriers over which it has jurisdiction.

The three classes of tax barriers to highway commerce might be titled, respectively, multiple taxation, discriminatory taxation, and taxation of special groups. Multiple taxation becomes a trade barrier when a trucker doing an interstate business has to pay a registration fee in more than one state. The interstate trucker is thereby burdened with a higher cost in the form of registration fees than his competitor who does a purely intrastate business.

Some states relieve an out-of-state truck of the obligation of paying a registration fee, only to impose in its place a ton-mile tax at a higher rate than the rate charged for trucks which have paid the registration fee. Here is an example of the second class of tax barriers to interstate commerce on the highways—discriminatory taxation.

As you may have guessed, the third class, taxation of special groups, is intended to cover special taxes on merchant truckers. These entrepreneurs must pay the regular motor-vehicle taxes on the trucks they use. Duplication of registration fees and discriminatory taxation upon out-of-state trucks is probably more burdensome to merchant truckers, whose volume of business may be expected to be smaller *per state* than the volume done by other classes of truckers. Merchant truckers are also subject in some states to license fees payable by dealers in farm products. In these states merchant truckers are included with other dealers in farm products, and must obtain a license in order to engage in buying farm products.

In addition to these highway and dealer's fees, however, merchant truckers are required in several states to comply with special legislation that applies to merchant truckers as such. These states license them to do business as merchant truckers. In Iowa the fee is graduated from $10 to $40 per annum on each vehicle, according to the maximum load which the trucker may carry at any one time. In Nebraska the fee is $25 a year for each vehicle used, and apparently there is also required a registration fee of $25 for the vehicle itself in addition to any fees imposed by other laws regulating the registration of motor vehicles. Montana requires merchant truckers to pay a license fee of $100 yearly for each vehicle used.

Besides license fees, these states require surety bonds to provide recourse in the event the trucker is found guilty of fraudulent practices. In Montana a bond of $1,000 must be posted; in Nebraska, one of $250; and in Iowa, one of $250 for an applicant "operating with more than 2,500 pounds actual load." The Iowa statute also requires the trucker to file an insurance policy giving five and ten thousand dollar coverage against public liability and one thousand dollar coverage against property damage.

There are good reasons for regulating merchant truckers. What kinds of regulation should be imposed is a subject that cannot be gone into here, but I think it would be a mistake to condemn all such regulations, regardless of their nature. It should be pointed out, however, that if state laws of the kind just described become widespread, they will seriously interfere with interstate trade carried on by merchant truckers. If a merchant trucker must pay a sizable license fee and post a bond in each state in which he wishes to do business, he will be penalized for crossing state

lines. It seems fair to call such a situation a barrier to interstate trade.

It should be possible to evolve a plan that would permit effective regulation of merchant truckers without discouraging them from doing an interstate business—a plan under which a merchant trucker would be required to take only one license, entitling him to do business in any state, to post a bond only once, and so on.

In connection with trade barriers, attention should be called to one other feature of the existing merchant-trucker laws. These laws exempt farmers carrying their own products to market. A result of this exemption is discrimination against farmers who, because they live at a long distance from the market or for other reasons cannot afford to spend their own time in going to market, prefer to send their products to market through a trucker. This is not so much a barrier against interstate commerce as it is a barrier against what might be called inter-local commerce.

Some states have included in their laws against merchant truckers provisions which are aimed directly against out-of-state produce or against persons residing outside the state. One such state law, for example, reads in part as follows:

> All persons, firms, or corporations domiciled outside the state of Louisiana, engaged in bringing into the state, eggs, poultry, fruit, vegetables, or nuts, whether grown, raised or purchased by them, said eggs, poultry, fruit, vegetables or nuts transported over the Louisiana highways by motor vehicles or trucks whether owned, or for hire trucks, for the purpose of retailing, wholesaling, peddling or hawking; that they be required to equip their motor vehicles or trucks with Louisiana license plates before being permitted to operate in this state.
>
> All persons, firms or corporations as above set forth shall pay an annual state license, which license is hereby fixed, classified and graded as follows, to wit:
>
> . . . . .

When traveling in a motor vehicle or truck, two hundred dollars ($200.00).

Another state law of this type requires "traveling merchants and peddlers" *who are not residents of the state and who vend foreign merchandise* to pay a registration fee of from $5 to $20 in each county in which they wish to do business.

The Farmer's Concern in Highway Trade Barriers

The farmer's concern in highway trade barriers may be stated briefly. Such barriers add to the costs of transportation of farm products, widen the margin between farmer and consumer, and reduce the farmer's share of what the consumer spends for agricultural products.

Highway trade barriers raise the cost of transportation in several ways. Non-uniform state size and weight limits often require loads to be transferred from one size truck to another and thus increase handling costs. Duplication of registration fees obviously adds to truckers' costs. The delays and red tape that are a part of certain types of trade barriers are another source of increased expense to truckers. All of these things must be covered in the rate that truckers charge and thus add to the costs of transportation.

Obviously, a higher charge for transportation services will operate to widen the margin between the prices farmers receive for their products and the prices consumers pay when these products reach them. The incidence of an increase in this margin upon farmers and upon consumers would be similar to the incidence of a sales tax. It would vary from one product to another and would depend, of course, upon the nature of the supply and demand curves for the respective commodities. But it is a truism that the greater the share of the consumer's dollar expended to

transfer the product from the farm to the dinner table, the less will be the share received by the farmer. Unless an increase in margins represents additional services for which consumers are willing to pay, it will result in a diminished demand at the farm for the products of the farm. Any increase in charges without a change in services rendered must reduce demand at the farm, and, correspondingly, a reduction in charges without a change in services rendered must increase demand at the farm.

I would like very much to present a quantitative estimate of what highway trade barriers have cost farmers. This cannot be done, however, for the reason that no such estimate has been made.

One of the important things students of trade-barrier problems could do would be to measure some of the economic effects of trade barriers. The chief criticism that has been made of the report *Barriers to Internal Trade in Farm Products*, published by the Bureau of Agricultural Economics of the United States Department of Agriculture in March, 1939,[1] is that it does not contain enough quantitative information about the economic effects of the barriers studied. This is a good criticism. But if an attempt had been made to include some quantitative estimate of the effects of barriers in each field covered, probably the report would not have been released even yet. It would have been necessary to originate a great quantity of statistical information scattered over 48 states and over many fields of economic activity. The economic effects of trade barriers will probably have to be measured piecemeal, and it will very likely be some time before an adequate quantitative estimate of the situation existing in broad fields can be obtained.

In place of statistical estimates of the effects of highway

[1] Taylor, George R., *et al.*, *Barriers to Internal Trade in Farm Products.*

barriers upon farmers, I shall present some examples cited in the report just mentioned. These examples of difficulties that arose out of multiple registrations and ton-mile tax requirements describe situations that existed two or more years ago. They are used here to serve as illustrations of the problem under discussion. It may be that most of these particular situations no longer exist; yet there is little doubt that a survey conducted today would uncover as many examples of the same kind.

The *New York Packer* for August 31, 1935, reported a conference held at Columbia, South Carolina, between a delegation of peach growers and certain members of the state legislature. It is described as follows:

> The conference was the outgrowth of difficulties encountered by peach growers during last season's peach harvest when state highway patrolmen began enforcing truck licensing regulations against trucks from states which did not have reciprocal agreements with South Carolina, mainly those from Tennessee.
>
> Peach growers claimed that they had suffered large losses as the result of the enforcement of the regulations against foreign trucks, and means for remedying the situation were discussed at a meeting with the county delegation here last week. Sentiment at the meeting was that trucks coming into the state to buy perishable produce should be exempted from licensing requirements regardless of whether South Carolina has reciprocal agreements with the states in which they are registered.

In the course of the study made by the Bureau of Agricultural Economics many letters were received from what are believed to be well-informed local sources, describing difficulties in marketing farm products that had been caused by trade-barrier situations. Here are some excerpts from these letters:

From Connecticut:

> Some of our growers have run into serious difficulties in trucking farm products into Maine, because Maine requires that all trucks of

more than a ton and a half capacity must be registered in Maine and pay their regular license fee.

From Kansas:

I would say that we are having interminable trouble in farm truck transportation between our neighboring states. It is reported that the laws and rules and regulations, particularly of Oklahoma and Missouri, almost make it prohibitive for Kansas farm trucks to cross the line.

From South Dakota:

The truckers have very often been held up because of the fact that they did not have a state license in addition to the one in which they resided, and such practices have resulted to the detriment of our stockmen. A commercial trucker may be in a position to take out a trucker's license in more than the one state, but this is not true of the farmer who does his own trucking.

From Illinois:

The chief handicap in the interstate movement of livestock to this market rests in the lack of reciprocal agreements concerning licenses and the abolition of mileage taxes. Illinois and Missouri have complete reciprocity on trucks hauling farm products on a so-called "farm-to-market and market-to-farm movement." If this reciprocity could be extended to other states, and Illinois is taking a more lenient view in this respect, it would remove many handicaps to interstate traffic.

The Bureau's report contains a table that describes the circumstances and some of the results of what might be called "border wars" that flared up in the years from 1931 to 1937,[2] usually resulting from a breakdown of reciprocity agreements between states.

There were intermittent "wars" between Illinois and Wisconsin during the entire period studied. The underlying cause was Wisconsin's requirement that out-of-state trucks be registered. Many truck drivers were arrested on both sides of the border. Perishable foodstuffs were held up.

In November, 1932, Pennsylvania involved itself in a

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[2] These years, 1931 to 1937, were the only ones included in the investigation of "border wars." Doubtless, other years brought other wars.

"war" with New Jersey and other states when it began to enforce a law requiring licensing of all trucks owned by non-residents and operated in Pennsylvania for hire or on regular schedules. As a result traffic was tied up at all Delaware River crossings. Trucks were forced to avoid Pennsylvania. Within two hours, more than two hundred Pennsylvania trucks were stopped by New Jersey inspectors. Tons of produce were threatened with destruction.

In July, 1935, West Virginia, on the one side, and Virginia and Maryland and other states on the other, quarreled over the West Virginia law requiring for-hire trucks from other states to have permits to operate over West Virginia roads. One result was that orchardists of the east panhandle of West Virginia, ready to move their July fruit, found it difficult to get trucks for that purpose.

How Can the Problem of Highway Trade Barriers Be Solved?

"Fools rush in where angels fear to tread." I fear that this old saw is an apt description of my temerity in tackling a problem that bristles with special difficulties. Students of taxation and students of transportation will undoubtedly see many problems which are not apparent to me. But it appears that the public discussion of trade-barrier problems has proceeded to the point where their existence is pretty well recognized and to a point where a search for solutions is necessary as proof of our earnestness. I wish, therefore, to mention some suggestions that have already been made for solving highway trade-barrier problems, and to add one or two of my own.

Since the chief interest of this group is in taxation, I shall put to one side the important problem of highway barriers arising from non-uniform state weight and size restrictions.

First, I do not see any way to avoid the conclusion that duplication of state registration fees should be eliminated. In other words, trucks in intrastate and interstate commerce alike should be subject to only one state registration; for as soon as a trucker must pay a second registration fee upon crossing a state line, interstate commerce is subjected to a burden not imposed upon intrastate trade.

The same argument holds with regard to gasoline or ton-mile taxes imposed at a higher rate upon interstate trucks than upon intrastate trucks. It seems evident that these also should be eliminated.

The gasoline tax is the most easily administered tax on motor vehicles, and it also goes far to apportion taxes on motor vehicles in proportion to use of the roads.

As the weight of trucks increases, however, the gasoline they use does not increase in proportion to the strain the trucks place upon the roads; with the result that if the roads are maintained by funds made available chiefly out of gasoline taxes the lighter vehicles will pay not only for the upkeep of the roads that is made necessary by their own travel but also for part of the upkeep made necessary by the use of the roads by the heavier vehicles. The ton-mile tax is generally considered to overcome this difficulty and to distribute costs of maintenance in the most equitable manner among the trucks that use the road.

Ton-mile taxes, however, are hard to enforce. In collecting them the states must rely upon reports made by the truck operators themselves, and unless this system of reporting is supplemented by constant check-up work by the state a premium is placed upon dishonesty. Truck operators who fail to report in accordance with the law benefit at the expense of those who obey the law.

Enforcement of the ton-mile tax is especially difficult

against out-of-state operators and particularly against those who do not make regular trips into and through the state. This is one of the problems that has led several states to set up ports of entry. Plainly, some method of keeping informed about the movements of out-of-state trucks into the state is essential to adequate enforcement of a ton-mile tax law. It seems to me that any method of state enforcement which could be devised would necessarily burden interstate truckers to a greater extent (by causing delays, making red tape necessary, etc.) than it would burden intrastate truckers, who have a place of residence within the state, who make reports of various kinds to the state in connection with their residence, and who therefore can be much more easily checked through records available to state administrative agencies. There is some question in my mind whether the advantages of the ton-mile tax over the gasoline tax are sufficient to outweigh the administrative difficulties incident to its collection.

A minimum program which could be put into effect through state action, and which seems quite practicable, though it does not appear to me to go far enough, was suggested by Dr. W. Y. Elliott of the School of Government, Harvard University, at the hearings on interstate trade barriers before the Temporary National Economic Committee in Washington last March. Dr. Elliott suggested that trucks only occasionally using the roads of a state could be granted exemption from payment of a registration fee in that state, without much, if any, resultant reduction in the revenues of the state, for the reason that such trucks do not now contribute to the revenues of the state because they cannot afford to pay the fees that would be imposed.

Some progress has been made through reciprocity agreements to eliminate duplication of registration fees. The

rate of this progress has been slow, however, and apparently it will be next to impossible ever to achieve complete reciprocity throughout the country because there are a few states which take the position that, as their highways carry a much higher than average proportion of interstate traffic, reciprocity would throw upon their taxpayers a disproportionate share of the burden of maintaining highways used principally by nonresidents of the state.

To my mind this argument is valid if the states in question do not impose a ton-mile tax. However, if they do impose such a tax, interstate trucks would automatically pay their share for the maintenance of the highway system.

I am not sure to what extent or in what ways the federal government might help to achieve a system of highway taxation that would minimize the barriers to interstate trade. Perhaps the collection of the state ton-mile taxes could be facilitated and the trade-barrier aspect of these taxes eliminated at the same time if interstate carriers were required to make their ton-mile tax returns to a federal agency. This agency would act as collecting agent for the states and would distribute to the states their respective shares of the returns from the ton-mile tax. It should be possible to work out a cooperative arrangement between this agency and the appropriate state bureaus for the adequate enforcement of the state ton-mile tax legislation. It might be necessary to stipulate, as a condition precedent to the federal agency's entering into cooperation with any particular state, that that state's rate of ton-mile tax should not be unreasonably high—and "unreasonably high" presumably would be defined in terms of cost of maintenance of the state's highway system.

Perhaps it might be better to abolish ton-mile taxes, and in their place to levy graduated federal registration fees

upon trucks used in interstate commerce. The receipts from these taxes could then be apportioned back to the states in proportion to their costs of maintaining highways for interstate traffic and in proportion to the volume of such traffic using their highways.

Still another possibility would be to depend neither upon ton-mile taxes nor upon federal registration fees, but upon a combination of (1) nonduplicating state registration fees, and (2) gasoline taxes which would differ from our present taxes in that a higher rate of tax would be levied upon gasoline purchased for use in trucks than upon that purchased for use in passenger cars. Although the idea of imposing different rates of gasoline tax upon different classes of purchasers may be a novel one, I am not sure that it would entail any greater administrative difficulties than those that are met with in collecting ton-mile taxes.

Many who are present here undoubtedly can improve upon these ideas or point out impracticable features. Certainly we should be turning our thoughts toward constructing a workable system of taxes on motor vehicles that will be as nearly free as possible of trade-barrier aspects.

As for the power of the federal government to participate in such plans, in view of the expertness of this audience in the legal aspects of highway taxation and my own lack of knowledge of the field, I shall rely on a few sentences that occur in Dr. Elliott's testimony at the hearing I have mentioned. These sentences are as follows (the italics are mine):

> On the question of the exaction of compensation for the use of state roads there is an early dictum indicating that the state had an indefeasible right to compensation for the use of roads as against the Western Union Co., which was operating under a federal license to use roads which had been designated as post roads. However, assuming the property rights of the state to be like private property rights—but they

may be an attribute of sovereignty—there is no reason to say that the federal government may not make reasonable regulations on the ground of the commerce power as it has with respect to the railroads. *However, with grants-in-aid used for the road system, there is no reason why the federal government should not make whatever regulations it chooses.* There is already a statute on the books denying grants to such states as fail to maintain their present proportion of appropriations from vehicle taxes to road uses.

CHAPTER IV

HIGHWAY TRADE BARRIERS AS VIEWED BY THE HIGHWAY USER

CHESTER H. GRAY

Director, National Highway Users Conference

THE highway user views highway trade barriers in the light of the reasons originally advanced by those persons and associations which have sponsored legislation to put such barriers into effect. It is necessary to continue to measure these barriers, so far as their effectiveness or their harm is concerned, by the same yardsticks which were applied to them when they were initiated.

REASONS FOR TRADE BARRIERS

The main reasons for trade barriers, advanced by their sponsors, have been many; but most of these reasons may be included in five categories: (1) more revenue, (2) highway safety, (3) quarantines, (4) road protection, and (5) hindrance to highway transportation. The four reasons first stated have been publicly and frequently used by those who support highway trade barriers. The fifth reason here given seldom has been stated by the sponsors of this type of legislation and ordinarily is denied as being a reason for highway trade barriers.

More Revenue

Highway users, in regard to a study of such barriers as ports of entry and lack of reciprocity among states, like to

consider the revenue proposition from the simple vantage point of whether or not highway barriers really cause any more revenues to flow into the state treasuries. Indeed, it has been made to appear in more than one state that such highway barriers as ports of entry have added materially to state revenues. But the clearest way to understand this port-of-entry controversy is to determine, in advance of any scrutiny of bookkeeping methods at state capitals, whether or not the revenues attributable to highway barriers, such as ports of entry, would accrue to the state treasuries if the ports were not in operation.

In some states which maintain ports of entry around their borders, the collection of the gasoline tax, which in most states is adequately accomplished without ports of entry, is all tallied up with the income attributed to the ports of entry. The casual conclusion is arrived at, when this method of bookkeeping is followed, that the port of entry as one highway barrier is more than paying its way. The highway users who are really students of this situation are not confused by gasoline tax collections at ports of entry; or compensatory fees; or other special taxes that in some instances were enacted after the port-of-entry statutes were placed in operation for the obvious purpose of giving the ports enough to do to justify their operation and continuance.

So, in viewing the revenue proposition, highway users insist on drawing a line between revenues which would accrue to state treasuries whether or not highway trade barriers existed and the revenues which may be traced directly to such highway barriers as ports of entry. With this severe demarcation in the revenues, which are frequently treated confusedly as a part of the discussion on highway trade barriers, it may be seen that ports of entry

fail to live up to their promises of adding materially to state funds.

Highway Safety

In regard to highway safety, an original objective held in mind by those who first sponsored highway trade barriers, it may be stated that the promises in this regard have not fully developed. Voluminous reports, of course, are on file in state capitols to show that ports of entry are a great contribution to the cause of highway safety. But closer examination frequently discloses that the ports are not equipped, either in personnel or with equipment, adequately to pass judgment upon the vehicles examined relative to safety. In many instances scales to weigh loads are lacking; in other instances superficial examination of brakes is given; not infrequently the ports are wholly without equipment to test the brakes, thus leaving the guardsmen to test them by sight and observation; and lights are about the only equipment that is inspected thoroughly, which, of course, can be done by the simple process of turning the light switch on and off.

Those who support highway trade barriers, however, are fond of arguing in favor of these barriers on account of their alleged contribution to highway safety. It is difficult to produce data to show that highway accidents or fatalities are less in the states having highway barriers than in those which handle the highway safety proposition by other means. This situation causes at least an inference that the great objective of highway safety has many another mechanism than highway trade barriers to promote it; and in doing so keeps highway safety from being embroiled in the controversy now raging around the highway trade-barrier proposition. Highway safety is meritorious enough and is so

universally desired that it should not be made a part of the port-of-entry controversy.

Quarantines

Not a few of the states have given great accent to the highway trade-barrier situation, and particularly to ports of entry, in their reputed connection with the maintenance and administration of quarantines to prevent the spread of plant and animal pests and diseases. This situation proceeded to such a point, not many years ago, that some ports of entry substantially were quarantine stations; were stopping travelers in all sorts of vehicles for examination; and in so doing were bringing the desirable state and federal quarantine laws rapidly into disrepute.

States which were most interested in the maintenance of quarantines and which happened to have highway trade-barrier statutes soon discovered—as, for instance, California—that it was very unwise to mix quarantines with ports of entry. This situation proceeded to the point where the nation-wide approval of quarantines to aid the farmers and consumers in the control of noxious animal and plant diseases was losing that high standing in the public mind which theretofore it had enjoyed. This is another instance in which a perfectly good public service of government was becoming entwined with another activity of government which was largely being questioned, and from many sources, like the highway user groups, wholly condemned.

As a consequence, one hears a minimum these later days of support given to ports of entry because of their quarantine significance. Quarantines are standing on their own bottom, as it were, and whenever a state wishes to protect its plants and animals from infection, and does so in compliance with federal quarantines, the public is willing to

tolerate the slight annoyance for this purpose. But the public is not willing to have quarantines used as an expedient to obstruct highway transportation. The public has already shown its resentment against this effort.

Protection of Highways

The early advocacy of that aspect of highway trade barriers represented by ports of entry gave great attention to the necessity of protecting the highways from destruction, or, at least, deterioration, from overloading the heavier types of motor vehicles. Next to the thought that more revenue would be secured from a highway trade barrier, the protection of the road was the most important argument for ports of entry and the accessory highway barriers which revolve around the ports. But the costs of maintenance of the highways in the states which have ports of entry, as compared to the similar costs in other states, give little support to this original argument. In recent months the widely acclaimed study of the former Coordinator of Transportation, on the general question of transportation aids, made public the dictum that it is not traffic that causes road deterioration so much as it is weather. In fact, Chairman Eastman states that approximately 75 per cent of maintenance is caused by weather, and only 25 per cent by traffic.

However sincere the original proponents of ports of entry and similar highway trade barriers might have been, in arguing that the roads must be protected at the state boundaries, there is little sincerity and no conclusiveness in a continuation of that argument, now that the Eastman Report is before us. Furthermore, as has already been pointed out, if, as is frequently observed, the border barriers have no facilities to weigh the loads, the argument that highway

trade barriers protect the highways against overloading is largely neutralized.

The users of the heavier highway vehicles, manufacturers thereof, and the motor vehicle administrators have learned and have perfected methods of putting more wheels under the loads, so that an original concept or idea that the heavier vehicles tore up the highways and, therefore, should be partially unloaded, or turned back at the state line, is no longer tenable. We have learned, or are learning—and in this the highway trade barriers have contributed nothing—that a reasonable wheel load of 9,000 pounds may be multiplied with complete safety to the road bed by placing additional wheels and axles under the load.

This procedure is advancing many times faster as a protective measure for the roads themselves than is resulting from restrictive measures at state lines. Significantly, in this connection, the states that have few or no highway trade barriers are making as much progress in spreading the gross load on a number of tires as is being accomplished in the so-called barrier states.

Briefly, it may be stated that the argument in favor of highway trade barriers as a means of protecting the roads has given, and must give, place to the natural development and evolution which is seen on every hand in protecting the roads by spreading the load over more wheels rather than spreading it on the ground at a state line.

Hindrance to Highway Transportation

Of course, it has been evident in more than one state that the real argument, seldom stated however, in support of one or another highway trade barrier has been that these barriers really do obstruct the free flow of interstate commerce by highways. And in obstructing interstate highway com-

merce no measurable benefit is conferred upon intrastate highway traffic. A good force of public opinion has turned against highway barriers. The hidden reason for such barriers, that they serve to obstruct highway transportation, has been publicly disclosed and is now meeting the full force of adverse public opinion.

Whether one or another or all of the reasons thus far mentioned for the original enactment of statutes having to do with highway barriers are observable in a particular state, it must be recognized that highway barriers appear in various forms. Ports of entry are most in the public mind because of the fact that they are easily seen by anyone entering or leaving a port-of-entry state. Visual education has made the highway traveling public conscious of ports of entry, but other highway barriers exist.

One which is as important as are ports of entry, and frequently is said to be demonstrated at the ports, is the lack of reciprocity in regard to motor vehicle laws between two states or among the states. A particular feature of the lack of reciprocity is the divergence in sizes and weights of motor vehicles, in regard to which few states have in force identic specifications. All of this will clear out and will be supplanted by uniformity in sizes and weights of motor vehicles and by that complete reciprocity among the states which the commerce clause of the Federal Constitution guarantees in regard to all interstate commerce when, and if, the federal government cares to apply the powers resident within this clause to highway transportation.

Conclusion

Compensatory taxes, clearance fees, special mileage taxes, the 20 gallon motor fuel tax which some states attempt to enforce, inspection and sealing of various cargoes (par-

ticularly liquor), inspection of insurance requirements, and other fees, charges and regulations, whether singly or collectively administered by any state, constitute highway barriers which highway users dislike. In fact, it may be said that highway users dislike all of these state-erected barriers to the easy flow of highway traffic across state lines so much that they hail gladly the advent of a national defense era. This era, it is believed by highway users, will go far to eliminate definitely one and all such state line highway barriers. Highway users in this point of view are not becoming militaristic; they are merely continuing their opposition of a decade against obstructions and hindrances to interstate highway commerce.

Some will resist—these resisters not being representative of highway user organizations to any appreciable extent—the entrance of the federal government into these state barrier situations. But as surely as the commerce clause was written in 1787 as a part of the Federal Constitution, and being so ancient of days as not to be attacked as a modern innovation in government, just so surely will it develop that sooner or later the federal government will take charge of interstate highway commerce, as it already has done in regard to other methods of transportation. Much of the present trouble relative to highway barriers traces to the fact that the federal government has not fully put into effect its delegated powers, powers surrendered by the states, relative to interstate commerce on the highways. Highway users would prefer for the states to become national enough in their points of view to "beat Washington to the draw" on this controversial issue. But if the states do not act, and if they fail to act with considerable speed, the present movement of the defense campaign and the control of all interstate commerce given Washington by the commerce clause

of the Constitution will certainly solve the problem and solve it in short order.

But states can solve it, or move toward its solution, by the adoption of reciprocity laws with regulations pointing toward complete reciprocity among the states. The states can solve it, at least in large part, by the incorporation into their statutes of the formula relative to sizes and weights of motor vehicles which has long been established by the American Association of State Highway Officials, with such modern modifications as regional and vocational conditions require and as recent developments in highway building, construction of the internal combustion engine, and multiple wheels under heavy loads permit.

The states can solve the problem, in part, by retreating from that concept of retaliation one against the other in regard to highway traffic matters across state lines, which has characterized them too much. The states can solve it, in part, by at least making an effort to enter into state compacts which for a region, if not for the whole nation, would, when adopted, eliminate state barriers. The states can hasten the solution of the highway barrier problem by recognizing the impetus recently given to many national problems, highway transportation being one, in the sudden desire and demand that the nation be adequately defended against all invaders, and within itself.

Finally, the states can solve this problem by listening to and acting in compliance with the full force of public opinion which has expressed itself nationally to the effect that commerce by any method of transport is a national enterprise and must not be obstructed at state lines.

If the states by one or more of these methods do not apply themselves with some haste to the solution of the highway barrier situation, it is reasonable to expect that Congress

for itself, or acting upon recommendation by the Interstate Commerce Commission, will take charge of interstate highway commerce.

Among the devices which the federal government has at hand to use in this enterprise may be mentioned the federal authority relative to sizes and weights of motor vehicles in the Transportation Act of 1940, or in an amended form, if such amendment is necessary; the inclusion in federal aids and grants of provisions denying such benevolences to states that violate and obstruct the commerce clause of the Federal Constitution; and such administration of national defense as to make it possible not only for munitions, equipment and military supplies to move over the highways freely, but for people and products, which are also essential in the matter of national defense, to be permitted to move freely across state lines alongside trucks, tanks, and all other defense equipment and commodities.

CHAPTER V

TRADE BARRIERS FROM THE RAILROAD VIEWPOINT

L. W. HORNING

Regional Director, Research, Association of American Railroads

I SPEAK to you on the complex and important subject of trade barriers to interstate movement of commodities from the point of view of the railroads. This confines my remarks to the subject of transportation and leaves other phases of the subject for those who are qualified to discuss them.

TRADE BARRIER DEFINITIONS

From the point of view, then, of transportation, I raise the question—What is a trade barrier? This is an important phase of the subject which has, for purposes of their own, been neglected by those who were advocating this or that as a trade barrier. I am reminded of the classic French exclamation—"Oh Liberty, what crimes are committed in thy name!" During the past two years, innumerable economic sins and unfounded complaints have been based upon trade barriers between the states, and there are those who are taking advantage of the use of slogans, such as "Balkanizing the United States," in order to accomplish purposes which are narrow and selfish in character. Some of these things I desire briefly to discuss.

Attempts have been made to define a trade barrier and two of them I propose to set before you. At a conference

of state representatives in Denver, Colorado, last year, there was developed this definition of a trade barrier:

> A trade barrier is a state law or regulation that deliberately discriminates against people, products, or services of another state in favor of the people, products, or services of the state which enacted such law or adopted such regulation; which actually does restrict or impair the free flow of commerce between states; which is not necessary to protect the property of the state or which is not necessary to promote the peace, health, morals, or welfare of its citizens and which can not be corrected by the orderly procedure afforded to all citizens by our courts.

The report of the Director of the Trade Barriers Section of the Southern Governors Conference, held on September 17, 1940, has this to say about trade barriers:

> These statutes (trade barriers) should be classified with care and discretion. To begin with, every exertion of the *taxing and police power* impairs the exercise of individual rights and to that extent *is a barrier*. But measures that compel groups to contribute their fair share to the state's revenue and bear a reasonable relation to public safety and health are not "trade barriers" in the true sense of the phrase.

It seems to me, therefore, that in considering the subject of trade barriers from the point of view of transportation at least, we must give consideration to these important factors:

(1) The law or regulation actually does restrict or impair the free flow of commerce between the states;
(2) The law or regulation does actually discriminate against the persons or products of a sister state and favors the persons or products of the home state;
(3) The law or regulation is valid under the Constitution and cannot be modified in the courts;
(4) The enactment of such law or regulation is not really necessary for the protection of property owned by the state, or for the preservation of its revenue, or for the protection of the peace, health, morals or welfare of its citizens; and
(5) The benefit gained by the law or regulation in the protection and preservation of the peace, health, morals or welfare of the citizens

> of the state is outweighed by the profit or gain which would accrue to the state if such protection were waived.

You see, therefore, that the question becomes a complicated thing and there are many phases of it which need careful examination. Perhaps, however, the whole matter may be boiled down to simple and practical terms.

Whatever may be said of laws or regulations connected with other phases, those which apply to transportation may be classified as follows:

(1) Statutory action by the states restricting sizes and weights of buses and trucks operating in interstate commerce;
(2) Statutory compulsion by state law that truck and bus operators from other states shall meet all the requirements placed upon truck and bus operators within the state and meet all reasonable costs and charges paid by the operators registered within the state; and
(3) State regulation to protect the legitimate interests of the citizens of the state in respect to standards and grades of commodities, in respect to existing marketing methods and practices and against the spread of infectious diseases.

In my opinion, every complaint made by individual operators of buses and trucks and by their powerful associations, so far as transportation is concerned, may be reduced to these three simple categories.

I have said that a trade barrier must be valid under the Constitution so that it cannot be modified in the courts. If there is a state law or a state regulation not supported by the Constitution, the orderly procedure is to deal with it in the court. Highway operators have endeavored to secure action by the courts that would enable them to increase the sizes and weights of motor vehicles in interstate commerce. They have failed to secure the support of the courts in this matter and now they are using widespread propaganda and high-pressure methods in order to accomplish their purpose by political action. Trade barriers and other slogans are

merely a smokescreen behind which they seek political preferment.

The reason that the courts have not supported their contention that state laws restrict the sizes and weights of motor buses and trucks below what the operators desire to use is that examination of the highway facilities within the state has clearly shown that the restrictive measures are reasonable. The measures, therefore, being reasonable, cannot constitute trade barriers.

The Issue of Reciprocity

In the field of transportation, operators over the highways have complained because state laws have required them to secure licenses within the state and have compelled them to meet reasonable costs and charges such as are paid by the operators registered within the state. This is the issue of reciprocity. You have often heard, and you will hear again, that any requirements by a state for registration fees and other legitimate charges against operators from outside the state constitute trade barriers. It is my opinion that so long as the charges are reasonable and so long as these charges are no more than those levied against home operators, there is no basis for complaint.

Here is the real issue, so far as transportation is concerned, in this whole matter of trade barriers. Those who complain against reasonable charges within the states are seeking to escape costs which may reasonably be placed upon them in order that they may more effectively compete with other agencies of transportation such as the railroads.

Let us pursue this matter a little further. Highway interests are seeking complete reciprocity among all states for commercial vehicles, just as we now have for the private passenger car. On January 30, 1933, a committee of rail-

roads and highway users issued a statement to which there was unanimous agreement on the subject of reciprocity between states. This agreement was that

> States should enter into reciprocal agreements for issuance of special licenses for commercial vehicles to cover states other than the home states *at equitable rates* to be determined by the conditions which prevail.

If this agreement means anything, it is a recognition that the states have a legitimate right to charge against operators from other states reasonable costs for the use of the state-owned and state-maintained highway facilities. So long, therefore, as the charges are reasonable, there can be no trade barrier.

The Issue of Sizes and Weights

Those in the highway transportation field who complain against trade barriers cite, also, the differences in permissible sizes and weights of vehicles that may operate within the states. They desire, of course, greater freedom for the operation of larger vehicles in order that they may haul more goods per unit, reduce their costs of operation and compete more effectively. In this, as in all matters connected with this question, they are seeking freedom from legitimate charges; they are wanting something for nothing.

They are urging in this respect uniformity of size and weight laws in all the states. Uniformity of size and weight of motor vehicles presupposes uniformity in highway improvement as to width and strength of pavement and bridges. There is no such uniformity in these facilities. The states have a right and a duty to protect their great investment in these facilities against abuse, overstress and destruction.

I point out to you these unassailable facts:

(a) The greatest investment that any of our states have made is in highways, streets, and bridges. More than 31 billion dollars have been spent for such facilities and their maintenance since 1920. It is certainly the duty and the responsibility of each state to protect its investment in these highways.

(b) In no two states do we have today any uniformity as to the number of motor vehicles on the highway. For example, in the state of New York there are 2,689,288 motor vehicles registered; in the state of Nevada there are only 42,296 motor vehicles registered. There cannot be the need for the same facilities in the state of Nevada as there is in the state of New York. Uniformity is impossible.

(c) There is no uniformity among the states as to the types of motor vehicles. New York and California, for instance, have more motor trucks registered than there are total motor vehicles in such states as Arizona, Arkansas, Delaware, Idaho, Maine, Mississippi, Nevada, New Mexico, and nine other states.

(d) There is no uniformity as to the use made of highway facilities. There is, for example, one use made of the highways by the private motorist in a light automobile, another use by the farmer in his light truck for short distances, another by the local deliveryman who seldom leaves the town or city, and in this class we may place the grocer, the baker and other merchants with their light delivery vehicles. These uses differ greatly from the use made of the highways by the great, long-distance trucking companies operating for hire. This is a regular, extensive use and cannot be classed with the others.

(e) There is no uniformity as to the number of miles of highways in any two states. In Texas, for example, there

are 188,229 miles of rural roads; in Delaware there are only 3,894 miles and in Rhode Island only 2,266 miles.

(f) There is no semblance of uniformity as to the types of highways, streets and bridge facilities among the states. For instance, Pennsylvania has some 30,675 miles of surfaced highways, Rhode Island has 802 miles, New Jersey, 1,670 miles. The term "surfaced mileage" itself has no uniformity in it. Some of this mileage is of concrete pavement; much of it is of flexible type or black-top pavement, wholly unable to withstand the stress of large vehicles.

(g) There is utter lack of uniformity among the states as to the ability to pay for highway facilities. The assessed valuation of real estate per mile of highway in Rhode Island is $416,446; in the state of New Mexico the assessed valuation of real estate is only $2,540 per mile of highway. Highway expenditures in 1939 amounted to only $5.74 per capita in New York, but the highway expenditure was over $76,900,000. In New Mexico the expenditure per capita for highways was $18.53, but the total was only $9,800,000.

There is a great difference in population, wealth, motor vehicle registrations, and available revenues among the states. There is also a substantial burden of highway debt now being borne by certain states, counties, and municipalities for highway improvements. Some states, some counties, and some municipalities have reached the legal limit of their bonded indebtedness. For the country as a whole, road bonds outstanding as of January 1, 1940, amounted to over two billion dollars. In the state of Arkansas road bonds amount to $141,900,000, or $72.83 per capita. In addition to the above road bonds, there are county and local bonds outstanding to the amount of more than $1,100,000,000 and municipal bonds for street improvements to the amount of $1,500,000,000.

Despite the stupendous expenditures in the last twenty years for highway improvements out of taxes and from borrowed funds, we find the American Association of State Highway Officials declaring that on our main highways there is immediate need for the expenditure of approximately four billion dollars, in addition, in order to bring these facilities up to a minimum standard.

In view of these facts it cannot be doubted that the states which have the financial responsibility for maintaining these highways have a corresponding right and an imperative duty to protect the facilities of their people. All reasonable limitations on sizes and weights of motor vehicles to operate over these state facilities cannot be called trade barriers.

The words of the Supreme Court, speaking of the state highways, should be remembered:

> It is well-established law that the highways of the state are public property; that their primary and preferred use is for private purposes; and that their use for purposes of gain is special and extraordinary. Generally, at least, the Legislature may prohibit the condition as it sees fit.

I commend these words to your careful consideration in this matter of trade barriers.

The attention of the advocates of trade barriers in the matter of highway transportation has largely been concentrated on such a state as Kentucky. It is claimed by them that the restrictions on sizes and weights of motor vehicles to be operated over the Kentucky highways constitute a trade barrier. Kentucky speaks for herself through the office of the First Assistant Attorney General of the state, who appeared recently before the Temporary National Economic Committee in Washington and said:

> We have been advised that certain interests have listed the Kentucky law regulating sizes and weights of trucks as being a trade barrier. I must confess that I do not know definitely what is meant by that use of

that term. I assume it means an unreasonable and improper interference with trade and commerce; but whatever it may mean, it is my purpose to show that the Kentucky statute is nothing more than a reasonable and proper exercise of the police power of the state for the preservation of public highways and for the protection of public safety, and that it is not either legally or economically an unreasonable or improper interference with trade or commerce.

The only aspect of this question in which we are interested is in maintaining the right of a state to preserve its property and to protect the safety and convenience of the public in its use of that property; and to show that this statute, attacked as a trade barrier, is a reasonable and proper exercise of the police power to accomplish the two purposes I have mentioned.

Railroad and Highway Taxes

I have charged that the operators on the highway are seeking to escape reasonable and legitimate costs which they should bear in order that they might compete more effectively with such an agency as the railroads. I suppose there are few people who desire to be regulated or taxed if they can avoid it. Let us look at their claim that if they paid all of the taxes and fees imposed by law in their home state, they should not be required to pay similar taxes and fees in other states over whose highways and streets and bridges they operate regularly.

Well, the railroads pay taxes. They pay taxes on every foot and yard of right-of-way and track. They pay taxes in every tax jurisdiction through which they operate. They pay taxes on their equipment in every state. They pay real taxes which are used for the support of government, and they maintain their own roadways too. Wouldn't it be fine if the railroads had tax reciprocity, so that if they paid a tax in the state in which their corporation has been located, they would have to pay no other tax in any state or any tax jurisdiction wherever they might run?

Of course, these taxes paid by the railroads must be met by revenues charged against traffic. Why should we not

call the cumulative taxes against the railroads a trade barrier between the states?

And, speaking of taxes, there is one item I should like to mention. I have stated that the railroads, being private enterprise, pay a tax on all of their property, including right-of-way, in every taxing jurisdiction. Highway operators, however, are not assessed a tax on the highway facilities owned by the state and used by them in their operations. A recent government publication has calculated that if a tax had been imposed at the rate of 1.25 per cent on the capital invested during the period 1921-1937 in the roadways, the tax bill would have amounted to $1,950,000,000. This amount the highway operators have escaped. The railroads have been compelled to pay such a tax year in and year out. Perhaps the railroads should have been crying for tax reciprocity,—lo, these many years.

And here is something to think about! In the year 1932, for example, the Class I railroads alone were taxed about $45,000,000 for highway and bridge improvements throughout the United States,—therefore we have a direct monetary interest in highway and bridge facilities.

And speaking of reciprocity, I would remind you, too, that the Pullman Company and the refrigerator car companies are taxed in most or all of the states, notwithstanding the fact that their cars operate over the railroad rights-of-way upon which the railroads themselves pay heavy taxes.

These taxes have been upheld by our courts and I have not heard the Pullman Company or the refrigerator car companies crying "trade barrier" because they are so taxed.

Highway Costs

I cannot refrain at this point from calling your attention to another important fact. It should be considered in connection with the complaint by highway users of trade bar-

riers. In the seventeen-year period 1921-1937, the total cost of highway improvement and maintenance was 25½ billion dollars. Highway operators of all kinds, including automobiles as well as buses and trucks, from all sources of payment account for only 10½ billion of this amount. In this seventeen-year period general taxpayers have paid 15 billion dollars toward the improvement and maintenance of highways and have thus relieved our bus and truck competitors from a heavy burden of costs. And yet they are seeking further relief by complaining against so-called trade barriers.

We hear a lot of talk in these days, and some of it comes from the interests connected with highway transportation, about the need for super-highways. At last we have such a highway. In the state of Pennsylvania there was completed a short time ago a great super-highway known as the Pennsylvania Turnpike. This facility was constructed at a cost of about $500,000 per mile. The Public Works Administration contributed $29,500,000 toward this project. This huge sum was an outright gift. A bond issue of $40,000,000 was sold with the understanding that the bonds were to be amortized over a period of 15 years by tolls to be paid by users of the highway. A schedule of tolls, devised as I understand it, to defray interest on the bonds and to amortize them in due time, was agreed upon and announced. Naturally the toll schedule provided for higher toll payments by the heavy trucks and buses than those imposed upon the private automobiles. Hardly had these tolls been announced before highway transportation interests began a campaign for a reduction of the tolls assessed upon their vehicles, and they accompanied their plea for a reduction in the tolls with the threat of a boycott. All this, notwithstanding the fact that 40 per cent of the costs of the facility represented an outright gift of tax funds paid by you and me and other taxpayers.

There is, of course, a way for highway transportation to avoid road use charges, size and weight restrictions, gasoline taxation, and other fees and regulations which are imposed upon its vehicles used on the public highways. How? Why simply to build their own highways. I doubt very much, however, if that suggestion will appeal to them. They would then be required to maintain their own highways and pay taxes upon their right-of-way, as the railroads are required to do, and such an arrangement would probably be more expensive than it is to use the public highways.

Kansas Port-of-Entry Law

Of all the laws complained about as trade barriers, perhaps the one most widely attacked and heartily condemned is the so-called port-of-entry law of the state of Kansas. The very term "port of entry" has been made to appear through propaganda as something awful, something to be abhorred and condemned, something un-American, but critics forget to point out that it is a very efficient method of collecting legitimate highway use taxes, enforcing necessary plant and other quarantines, the prohibition against gasoline bootlegging, etc. Mr. Strong, representing the state of Kansas on this program, can define the port-of-entry law of his state much better than I can do it, and is likewise a more able defender of it, but I was impressed with what he had to say about it when he testified last year before the Temporary National Economic Committee in Washington. Among other things, he said this:

> In the year 1931, the state of Kansas initiated a new system of taxing motor carriers for the commercial use of its highways. This new method of assessment was not for the purpose of increasing the tax burden of such carriers, but was enacted in the law with one purpose in mind—to provide a more fair and equitable means of distributing the tax burden among them. Prior to that time the tax was levied on the basis of capacity and weight of vehicles. It was collected through the customary

medium of the annual license plates sold to the truck owners, to be placed on the truck. The scale of fees paid was determined solely by the size and capacity of the vehicle. Nothing else made a bit of difference. The owner who operated his truck over the highways only 100 miles a month, paid identically the same fee as did the owner who operated 10,000 miles in the same month.

To correct these obvious inequalities of taxation, the Kansas Legislature determined that both weight and distance should be factors in determining the tax to be paid. The problem was given careful and detailed consideration, and resulted in the imposing of the gross ton mileage tax, which is exactly what its name implies. It assesses a tax of one-half mill per gross ton mile traveled, and acts upon all operators alike. The truck owner is called upon to pay his share of the upkeep of the state's highway system in direct proportion to his use of the highways.

Early experience in the administration of this system resulted in the discovery that an improved method of enforcement was a necessity. Some method of checking in the field was needed to prevent wholesale tax evasion. The taxpaying operator deserved protection from his less scrupulous competitor.

Mr. Strong went on to point out that ports of entry accomplished many other good things than the mere collection of highway use taxes. He pointed out that there was no discrimination as between vehicles of Kansas and those from other states; that, in fact, there were many advantages accruing to interstate operators by reason of the port-of-entry system. He appropriately pointed out that the system of operation in use by the state of Kansas through its port-of-entry law has yet to be criticized, or found to constitute a trade barrier by any of those conferences of officials studying the subject in which the Kansas port-of-entry law has been analyzed and discussed.

Regulation of Gypsy Truckers

There are also those who would condemn the regulation of the itinerant or gypsy peddlers as a trade barrier. An itinerant or gypsy peddler, as I refer to him here, is meant

to be the truck peddler operating here and there almost at will, not for hire, not over any established route, not with any established place of business, but who goes wherever he can get a load and who buys the commodity which he transports at one place, selling it at destination in competition with local, well-established, taxpaying merchants. He is engaged in both the business of merchandising and transportation, but not subject to the ordinary regulations and taxes which apply to other transportation agencies or established merchants.

In my opinion, a failure on the part of any state to regulate the gypsy peddler and to require him to bear his fair share of the tax burden is a *very definite trade barrier against the established merchant* who employs local labor, pays heavy taxes, and who must, by reason of the fact that he has to live and deal with the people of his community, conform to all the honorable practices required of such a merchant. If it is a trade barrier to regulate and tax the gypsy peddler, it is a trade barrier to regulate anyone for the purpose of preventing frauds, misrepresentation of grades of merchandise, etc. The Council of State Governments, considering this subject at its meeting in Chicago last year, refused to condemn itinerant peddler laws as trade barriers. They resolved, in effect, that such regulation is necessary and desirable, but pointed out that such regulations should not discriminate against the peddlers from other states in favor of local peddlers, and with that, of course, we all agree.

That such complaints are not supported by the farm producers' organizations is evidenced by the action taken in the state of Washington by the Washington Produce Shippers Association. The membership of that Association consists of cooperative organizations of farmers actually engaged in

production. Aroused by the adverse effects on farm income of the operations of gypsy truckers, the Association has taken a determined position in which they declare that:

> The inroads they have made upon distributive business and farmers' income have been due, not to efficiency, but to avoidance of the normal obligations of fair dealing, safety and living standards, and farm production quality. They have, to a large extent, destroyed the farmers' hard won quality standards, debased the prices paid to farmers, ignored laws of safety and public protection, and wrecked living standards of farmers, dealers, and of employees.

That Association, among other things, recommended the following:

> We demand that every truck handling agricultural products, either as a dealer or a carrier, be made effectively subject to every tax, license, permit, regulation, inspection, limitation of hours, safety requirement, bond, insurance, quarantine, marketing agreement, and to every other restriction imposed by state or federal laws for the protection of farmers and the general public. What we seek is equality of treatment of all those performing distributive functions in farm products, regardless of mode of conveyance, or difficulty of enforcement procedure.

Other groups, such as the Chamber of Commerce of the United States, grain and feed dealers' associations, merchants, and representatives of agriculture, have been no less vehement in their rightful condemnation of the gypsy truckers and the failure of authorities to regulate and require them to bear their fair share of the tax burden.

Conclusion

I think we must all agree that the tax burden should be equally distributed among all citizens, if possible. If this is to be done, we should see that no group of citizens is singled out for treatment any fairer than we accord others. One group should not be made to bear its own fair share of taxes and, in addition thereto, a share that rightfully belongs to another group, which is exempted. This is particularly

true of transportation. If one form of transportation shall be required to contribute to the support of general government and is taxed in all jurisdictions, then no other form of transportation should be singled out for more lenient treatment.

It should be the duty of taxing authorities to protect the ever decreasing tax bases. Government activity in business decreases the tax base, placing increased burdens upon those who must continue to pay taxes. Government activity in the field of transportation has grown steadily in recent years. The construction of air fields, waterways, and highways by government has greatly increased the tax-exempt property which must inevitably increase the rate of taxation on other property.

A few days ago the Westchester County Board of Acquisition and Contracts of Westchester County, New York, opened negotiations for the procurement of certain farm lands to be used as an airport. The land under consideration was a farm of 166 acres which has been on the tax rolls for many years. The use of this land for the purpose proposed would remove it from the tax rolls. It happens that the land is located in the town of Mount Pleasant, which, according to the press, already has some $20,000,000 worth of tax-exempt property, and so it is expected that the taxpayers of the town will oppose the location of the airport there. That is an example of what I mean.

A thousand and one laws, rules and regulations of the federal government, the states, and local subdivisions of government, affecting in some manner or other the operating, accounting, and safety practices have been enforced against railroad transportation for many years. As regards these laws and regulations which affect the railroads, we have throughout our history adopted the orderly procedure

provided for by our courts when we have felt unjustly treated or discriminated against. The law reports of every state and the federal courts are full of railroad cases revealing the battle we have fought—not by propaganda, but in the orderly way afforded to all citizens by law and our Constitution.

Motor transportation, according to its own figures, is handling more business almost every month than it handled in the same time a year ago. The increases in some cases are phenomenal, when compared to railroad business, and if, in fact, there are barriers working against interstate commerce in this country, it is obvious from the results that they are working more grievously against traffic moving by rail than they are against truck traffic.

Be not deceived by slogans such as "Trade Barriers" and "Don't Balkanize the United States." We are a sensible and reasonable people. We are not going to emulate the examples of the dictators or the Balkan States. We are not going to destroy interstate commerce in this country. On the other hand, we are not going to destroy state rights, not at least so long as we have the Constitution of the United States and the courts of our states and the federal government to rely upon.

Bring every trade barrier claim into the light, examine its origin and its purpose. Let it not be a claim in the name of righteousness which conceals a desire to escape reasonable and legitimate costs or reasonable or legitimate regulation.

CHAPTER VI

PORTS OF ENTRY

Floyd D. Strong

Attorney-Director, Motor Carrier Division, Kansas Corporation Commission; and Secretary, Kansas Port of Entry Board

In seeking a market for his products, the farmer, of course, has a vital interest in any tax legislation which might operate to inhibit the free flow of commerce between the states. With the rapid growth and development of motor carrier or highway transportation, and the ready adaptability of this mode of transportation to the needs of the farmer, he has an especial interest in the tax features incident to the regulation of motor carriers.

Likewise, the highway user engaged in the business of motor carrier transportation on a commercial basis has a vital interest in the growing field of legislation designed to regulate this increasingly important industry. Similarly, other existing transportation agencies are concerned with the development of highway transportation and must of necessity be interested in an equitable distribution of the tax burden as applied to competing forms of transportation.

Any discussion of a particular type of regulation must necessarily involve some detail. Therefore, in these remarks I shall try to be as factual as possible, rather than argumentative.

From the standpoint of the administrative body charged with the responsibility of administering regulatory legislation, the problem is a matter of honest and conscientious

application of the terms of the statute to the practical circumstances and needs of the industry, the regulation of which is sought. In approaching this problem as applied to the regulation of motor carriers, the state of Kansas found that an equitable distribution of the tax as applied to the out-of-state carrier was essential insofar as his operations became a part of and affected the highway transportation system of the state. For this purpose, the Kansas Legislature in 1933 enacted what is known as the Port-of-Entry Law in its present form. The port-of-entry plan is relatively new. It is, therefore, no more than natural that it should be scrutinized, and we are happy to explain our particular method of control, and indicate its aims and purposes.

Frankly, we feel that the plan has been a success. While we have had our problems, this plan has accomplished for Kansas an efficient means of exercising a reasonable control over motor carriers with an absolute minimum of difficulty, and without hampering freedom of commerce as carried on by motor vehicles.

To make an intelligent presentation of this subject, it is necessary to mention briefly a few of the conditions which brought this plan into being.

Origin of Port-of-Entry Law

In the year 1931, the state of Kansas initiated a new system of taxing motor carriers, for the commercial use of its highways. This new method of assessment was not for the purpose of increasing the tax burden of such carriers, but was enacted into law with one purpose in mind—to provide a fairer and more equitable means of distributing the tax burden among them. Prior to that time the tax was levied on the basis of capacity and weight of vehicles. It was col-

lected through the customary medium of the annual license plates sold to the truck owner to be placed on the truck. The scale of fees paid was determined solely by the size and capacity of the vehicle. Nothing else made a bit of difference. The owner who operated his truck over the highways only 100 miles a month, paid identically the same fee as did the owner who operated 10,000 miles in the same month.

To correct these obvious inequalities of taxation, the Kansas Legislature determined that both weight and distance should be factors in determining the tax to be paid. The problem was given careful and detailed consideration, and resulted in the imposing of the "gross ton mileage tax," which is exactly what its name implies. It assesses a tax of one-half mill per gross ton mile traveled, and acts upon all operators alike. The truck owner is called upon to pay his share of the upkeep of the state's highway system in direct proportion to his use of the highways.

Early experience in the administration of this system resulted in the discovery that an improved method of enforcement was a necessity. Some method of checking in the field was needed to prevent wholesale tax evasion. The taxpaying operator deserved protection from his less scrupulous competitor.

At the same time, Kansas was meeting a different problem —that of so-called "hot oil." Bootleg gasoline, escaping taxation both in Kansas and other states, created a serious problem in the state's gasoline tax administration. This gasoline, frequently of inferior quality, presented such a threat to the state's revenue from that source, that the Kansas Legislature provided a number of "registration offices" at which all importers of gasoline were required to stop and declare their cargo and destination.

Not only was the tax feature of the law enforced, but

surprising strides were made in eliminating unfair and fraudulent trade practices. Adulteration of liquid fuels was practically eliminated, and stolen gasoline was made a highly undesirable commodity to possess.

The use of these registration offices was so successful that, in 1933, the state determined to extend their functions to include enforcement of the gross ton mileage tax law, and the Kansas ports of entry, as such, were set up to perform these additional duties.

The establishment of these state agencies at the very borders of the state eliminates any inconvenience, expense, or delay to which motor vehicles would otherwise be subjected in making side trips, or rerouting themselves to go to central control points. It also dispenses with the necessity of contacting in advance state offices to secure authority to travel the highways of the state. This system, maintained at some cost to the state, is primarily for the convenience of the motor carrier, and makes it easy and economical to comply with the state law.

Operation of Port-of-Entry System

The taxation of motor carriers is not, and should not be, an item of profit to the state. In Kansas, the tax imposed is barely enough to maintain the highways, in view of the accelerated deterioration thereof caused by motor carrier operation, if indeed it is adequate to do so. The proceeds of the gross ton mileage tax are spent by Kansas for that purpose. The cost of administration is strictly limited to 10 per cent of the amount collected. It never has been contended that the Kansas gross ton mileage tax imposes an unfair or excessive burden upon motor transportation.

To be somewhat more specific in our explanation of the assessment and collection of the gross ton mileage tax, let us

examine its operation a little more closely. There are two methods by which this tax is imposed and, depending upon the circumstances, each carrier falls into one of these classifications. The majority of the operators, whether they are residents of Kansas or of some other state, and whether they are engaged in intrastate or interstate commerce, are registered and licensed by the State Corporation Commission. The State Corporation Commission of Kansas is the regulatory body authorized and directed to control motor transportation in the state. The individual carrier may fall within any of three classes—common carriers, contract carriers, or private carriers. Regardless of this classification, the carrier is required to keep a record of the movement of his vehicles and at the end of each month to report to the state, through the medium of its Corporation Commission, the miles which he has traveled. This mileage, together with the capacity and weight of the units operated, determines the amount of tax due. The carrier pays this tax at the end of the month, and that payment is, of course, based upon the actual use which he has made of the highways of Kansas.

The particular function of the clearances through the ports of entry by the regularly certificated carrier is to provide a check upon the carrier's mileage reports. From a practical standpoint it would be difficult, if not impossible, to have any idea whether his report was correct if it were not for the availability of this check.

We particularly ask that the members of the Institute note that the out-of-state operator is subjected to no discriminatory treatment in this connection. He has the same right to secure a permit; the requirements are no different for him than they are for the Kansas resident, except that he is required to appoint a resident agent to receive service

of legal process; his mileage tax is figured on the same formula and amounts to identically the same tax payment per ton mile operated as does that of the Kansas resident. The registered carrier from another state undergoes identically the same treatment at a port of entry as does the Kansas truckman. The ports of entry of the state of Kansas never have been, and are not in any way, instrumentalities of discrimination against carriers from other states.

Quite to the contrary, the interstate operator has, in some respects, many advantages, by virtue of the port-of-entry system. Unless he seeks to do purely intrastate business, he does not need to obtain Kansas license plates and pay the fee therefor. While this fee is not large in comparison with those charged in other states which use this method as the principal means of collecting compensation for the use of their highways, nevertheless this does give to him somewhat of an economic advantage.

As has been mentioned, there is another class of carrier affected by ports of entry. Out-of-the-state operators who desire to make only an occasional or infrequent trip into or through the state of Kansas are afforded a method of securing clearances through the Kansas ports of entry without the necessity of first securing a permit from the State Corporation Commission. The Port-of-Entry Law provides for and denotes them as "special permits" or as "special clearances." These terms are synonymous. To secure such a special clearance, an operator needs only to stop at the port of entry and state substantially the same facts as are required of carriers clearing in the regular way. In substance, he must describe his vehicle, his destination, his cargo, and the route or distance that he expects to travel in the state. He must likewise show that he has the necessary insurance in some company authorized to do business in Kansas.

Upon making these necessary declarations, and showing these facts, together with the fact that he is not making and has not made regular trips into the state of Kansas and does not desire to become a regularly registered carrier in Kansas, he is entitled to such special permit or clearance upon the payment of the mileage tax. In these cases the mileage tax is figured on a slightly different basis. The statute divides vehicles into three weight classifications, namely: those under 15,000 pounds, those over 15,000 pounds but under 25,000 pounds, and those over 25,000 pounds. On these special clearances the tax imposed is 1½ cents, 2 cents, or 3 cents per loaded mile, depending upon the gross weight of the vehicle and load, and the weight classification into which it falls. There is no application fee, delay or other impediment placed in the operator's path.

It will be noted that the rates of fees charged on these special clearances are slightly more than those charged the regularly licensed carrier. There is, however, this distinction—the regularly registered operator pays for *all* miles traveled, while the carrier operating under a special permit pays only for the *loaded* miles traveled. Empty mileage is not figured in ascertaining the tax under special permits.

Thus, an out-of-state operator seeking to make an occasional trip into or across the state of Kansas can come to its borders and in a few moments, and upon the payment of a small tax based upon the loaded miles he will travel in the state, secure a valid grant of authority from the state to travel its highways. There are no formalities or red tape in connection with securing this right. He is not required to make an application, pay a fee therefor, be present at any hearing, file any insurance, show the existence of any contract, or prove convenience and necessity, make any deposit to secure the payment of his tax, or do any other of the

numerous things required commonly by states in connection with their regular carriers.

In passing, we wish to note that under the Kansas Act, the owner of livestock or the producer of farm products is exempt from the payment of the mileage tax, and this is equally true of Kansas residents and residents of other states. Similarly, persons transporting their own property, where this property is not for sale, lease, or bailment, are totally exempt. In these cases, upon coming to a port of entry, the simple declaration of the facts will entitle the operator to an "exempt clearance," and a certificate to that effect is given, which will permit the vehicle to proceed through the state without further explanation or delay.

Ports of Entry Not Barriers to Trade

As you have no doubt noticed, we have reiterated in several particulars the absolute similarity of treatment received by the Kansas operator and the out-of-state operator. Our purpose in so doing has been only to show that the Kansas ports of entry are in nowise intended, or used, to work a hardship upon carriers from other states, or to raise a wall around the state which only the agile may scale. On the other hand, we believe this method is not only a valid exercise of the taxing and police powers of the state, but also is a most reasonable and proper exercise of these powers. This method has been carefully developed for the purpose of expediting the flow of commerce, simplifying the requirements placed upon the carriers, and adjusting the necessary tax load in the most equitable fashion. We sincerely trust that you will bear in mind that with the sole exception of the inspection of petroleum products and the sealing of intoxicating liquor shipments, there are created by the Kan-

sas ports of entry no embargoes, no inspections, and no harassing of the shipping public.

It is the sincere belief of the Kansas port-of-entry officials that our ports are not in any wise a barrier to trade.

The matter of the consideration of the practical operation of ports of entry is not entirely new. Various conferences in connection with trade barriers have considered the question, and the system of operation in use by the state of Kansas has yet to be criticized or found to constitute a trade barrier by any of these conferences in which the Kansas Port-of-Entry Law has been analyzed and discussed.

Situated in the geographical center of the United States, her fertile plains crossed by many miles of federal and state highways, Kansas, at the crossroads of America, welcomes the commerce of the nation, realizing that "trade" means "exchange" and that if she is to market the products of her fields, mines and factories, she may do so only when she freely receives the products of her sister states.

We firmly believe that the administrative officials of most of the states realize the importance of the free flow of commerce between the states, and that they are making a sincere effort to accomplish this purpose through revision of existing legislation or the enactment of new laws relating to highway transportation. Various agencies are now at work in an attempt to determine those tax factors which might be common to all the states. Obviously, the problem of proper distribution of the tax burden is one which varies greatly in the several states. Geographical location, physical topography, distribution of population, natural resources, and adaptability to agricultural and industrial development are some of the factors which must of necessity color the tax program of a particular state. It is only through symposia, such as this one conducted by the Tax

Institute, that a solution to this problem of tax barriers to trade may be reached. It is hoped that out of conferences of this nature will come a better understanding of this problem, and that there will result uniform tax programs which will foster and encourage the free flow of trade on the highways.

CHAPTER VII

SIZE AND WEIGHT RESTRICTIONS ON TRUCKS

JOHN V. LAWRENCE

General Manager, American Trucking Associations, Inc.

THE most important highway trade barriers are not reflected in actual tax payments, but are nonetheless a tax on the public. I refer to burdensome size and weight restrictions placed on motor trucks by various states. These limitations are not founded on sound engineering, safety, or economic reasons, but are solely the result of efforts to hinder highway transportation, referred to by a previous speaker.

EFFECT OF TRADE BARRIERS ON TRANSPORTATION COSTS

To repeat, these barriers are not actual tax payments but are a heavier tax paid by the public in increased transportation costs, in loss of time in receiving things, in increased accident hazards, and in highway congestion.

Reference has been made to a statement by an assistant attorney general of Kentucky before the hearing on trade barriers of the Temporary National Economic Committee to the effect that the roads of that state would not carry trucks heavier than the 18,000 pounds gross weight now allowed. I testified at that hearing and listened to the comments. This official, either then or to our knowledge to this day, has not answered two questions: namely, that if this be true, how it is that these roads can carry buses weighing between thirty and forty thousand pounds, and what has

happened to more than forty-one million dollars of federal aid furnished the state.

For example, a truck operating from Chicago to Atlanta must break down its load at the Ohio River into two or more trucks, because of Kentucky's low weight limits. This use of two trucks to do the job of one increases the cost of moving a ton of goods by 45 per cent. The transfer results in an average loss of time of from eight to ten hours, in many cases from twenty-four to thirty hours.

Government statistics show that more than 92 per cent of the truck accidents result from human failure or causes other than condition of the vehicle. By having two vehicles do the job that one can do satisfactorily, accident hazards are doubled. And it is obvious that highway congestion is increased.

As to the matter of general taxes, the present rearmament program poses a problem for all of us. The trucking industry, like all American industries, stands four-square behind the program to rearm this country to insure our security. As all other industries, and the whole people of the nation, the trucking industry knows the bill must be paid and that increased taxes are inevitable. The trucking industry, private and for-hire, pays all of the general business taxes that other industries or businesses pay, and, in addition, has been paying more than one hundred million dollars annually of the excise taxes on automotive equipment, parts, fuels and lubricants, collected by the federal government. No other form of transportation pays this special form of federal tax.

Since July 1, the federal gasoline tax, the major portion of these excise taxes, has been increased by 50 per cent, and the other items have likewise been increased. This further special imposition was placed on the trucking industry, while other forms of transportation were left scot-free.

Comparison of Highway Costs and Highway Taxes

College professors, retained by a competing form of transportation two years ago, issued a study of highway costs compared with tax payments by highway users. It purported to show, by statistical legerdemain, that highway users had been subsidized by some ten billions of dollars. The surprising thing about this report was that its authors did not say one hundred billions. It would have been equally ridiculous.

For the use of highways, all motor vehicles pay special taxes to the states—license fees, gasoline taxes, etc. The former Federal Coordinator of Transportation, Chairman Joseph B. Eastman of the Interstate Commerce Commission, recently issued a study on the so-called "highway subsidy question." The study showed that, without crediting motor vehicle owners with federal excise taxes or special motor taxes "legally diverted" by the states to non-highway purposes, motor vehicle owners overpaid their share of highway costs by $501,138,000 in the period from 1921 to 1937. The amount of overpayment was greatest in the later years, totalling $110,772,000 for the year 1937. Mr. Eastman found that trucks more than paid their share of highway costs, by as much as $287 per vehicle per year on the largest for-hire vehicle.

Thus, Mr. Eastman's report shows that the trucking industry not only more than pays for the highway use through special state taxes, but, in addition to paying general business taxes like all other enterprises, it pays special federal excise taxes visited on few other businesses and on no other form of transportation. It is thus paying more than its pro rata share of federal government imposts. It is interesting to note that of a total amount of $850,693,000 of

state highway income in 1939, $841,243,000 came from highway user taxes alone and less than three millions from general funds.

These special taxes devoted to highway use build roads for the public. Those who pay them have the use of a facility but obtain no title to the property they paid for. The trucking industry knows that it must pay its share. It is doing it now and is willing to do so. But there are many inequalities. For instance, in the Kansas port-of-entry system, truck operators who have already paid gasoline taxes in another state are assessed the Kansas state tax on the gasoline they use in that state, a clear case of duplicate taxation.

While a passenger car licensed in one state may travel in another state without paying license fees, etc., this is not the case for motor trucks. Thus, a motor truck operating wholly within one state will pay a license fee to that state only. If it operated in two or more states, in many cases it must carry two or more license plates, a fixed annual cost amounting to several hundred dollars in each state. To illustrate the patchwork picture, a truck whose home state is Missouri, operating from St. Louis to Indianapolis, must be licensed in each of the three states. A truck on the same run whose home state is either Illinois or Indiana must be licensed in its home state and Missouri if it travels over the same route—two license fees as compared to three for the Missouri truck.

In an operation between Chicago, Illinois, and Milwaukee, Wisconsin, for instance, a distance of 95 miles one way, two licenses are required, as neither state is reciprocal. The total license costs, plus gasoline and miscellaneous taxes, on a single tractor and semi-trailer combination for one of our carriers amounts to $1,508.50 per year.

While marked strides have been made in securing reciprocal agreements between the different states as to motor truck license fees and similar taxes, there is still much to be done.

Such duplicate taxation is unknown for any other form of transportation. This and other highway barriers have grown to such extent that they have moved certain nationally known editorial writers to devote their attention to the subject. Our country was rapidly becoming "The Untied States of America." Barriers between the states were becoming so numerous that they approached the European situation, so promotive of trouble and loss of trade.

With public attention focused on this question, may we hope that no time will be lost in removing these inequalities and burdensome restrictions, so that the people of America may have full use of *all* of their transportation facilities.

PART THREE

COMMODITY TRADE BARRIERS

CHAPTER VIII

BANNING THE USE OF MARGARINE THROUGH TAXATION

J. Wilner Sundelson

Department of Economics, Rutgers University

Margarine (oleomargarine), processed from animal and vegetable oils, is a food product used principally as a spread for bread. In other words, it is an alternative to butter; both are fat foods of similar caloric content and digestibility.

Developed originally in France, margarine was introduced into this country in the early 1870's, a period which saw considerable popular agitation against adulteration and fraud in the sale of food and drugs. It entered upon the scene just in time to become a special target for this agitation. Being an entirely new product, it was accused of being everything from plain fraud to deadly poison. Some of the accusations leveled against it were undoubtedly justified. There is considerable evidence to show that its sale to the consumer as butter was not uncommon. This fact helps to explain why margarine, at an early date, suffered the misfortune of arousing the enmity of the most powerfully organized agricultural group in America—the dairymen—which in turn explains the multiplicity of taxes and regulations with which margarine has been surrounded.

Early Legislation

The first legislation to control the sale of margarine was state and local in character. Prior to 1880 at least four

states—New York, Pennsylvania, Maryland, and Delaware—and the District of Columbia had passed such statutes, and by 1886, the year the first federal law was enacted, 22 states had some form of margarine legislation. Seven of these—Maine, New York, Pennsylvania, Michigan, Minnesota, Ohio, and Wisconsin—prohibited the manufacture and sale of margarine entirely. New Hampshire required that the product be colored pink. This stringent law, together with similar laws in four other states, was outlawed by the Supreme Court in 1898.[1] The rest of the 22 states had regulatory statutes of one form or another. There were also some license fees on margarine manufacturers and dealers. State legislation, then, was fairly common by the time the federal law was adopted, but taxation had not as yet been called in as a regulatory device.

Federal Restrictions

The entry of the federal government into the margarine restriction fight placed the states in the background till 1929. Before turning to a discussion of the federal law, it may be well to indicate its limiting effects on state legislation.

The fact that the federal government had recognized margarine as a legitimate article of interstate commerce, subject to taxation, led to the nullification of many of the more prohibitory state statutes. Prior to 1886 these had been upheld. In a series of new decisions on the subject, the Supreme Court concluded that a state might prohibit the manufacture and sale of margarine, but it could not prohibit its sale by the importer in original packages introduced in interstate commerce. A state might, however, prohibit the manufacture and sale within its borders of mar-

[1] *Collins* v. *New Hampshire*, 171 U. S. 34.

garine colored in imitation of butter, even when brought into the state from another state and sold in its original package.[2] Following these decisions, most state legislation took the form of the prohibition of manufacture and sale of margarine colored in semblance of butter.

In the early history of federal margarine legislation of this type, a number of bills proposing taxes on margarine were introduced in the 49th Congress and, logically, referred to the Ways and Means Committee. The dairy interests were strong enough to have these bills transferred to the agricultural committee which was known to favor their passage. The bill which finally passed in 1886 (24 Stat. 209) originally contained provision for a tax of 10 cents a pound. The purpose of the tax is clearly indicated by the following remarks of a Congressman from Wisconsin, fighting an effort to reduce the tax. "I should regret the reduction in fear that it might not accomplish the object that, I am free to say, inclines me to support the measure under consideration; for I fly the flag of an intent to destroy the manufacture by taxing it out of existence."[3]

Despite the gentleman's objection, the tax was reduced to five cents in the House and two cents in the Senate. It was the latter rate which became law. The same law also provided for annual license taxes of $600 on manufacturers, $480 on wholesalers, and $48 on retailers. The statute further provided for methods of packaging, labeling, and sale. The sponsorship and the motivating forces behind this federal levy point clearly to the fact that restriction of competition with the dairy industry was sought. In the history of the federal tax, which follows, there is evidence

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[2] *Powell* v. *Pa.* (127 U. S. 678); *Plumley* v. *Mass.* (155 U. S. 461); *Schollenberger* v. *Pa.* (171 U. S. 1).

[3] Bannard, H. C., "The Oleomargarine Law," *Political Science Quarterly*, II, (1887), 522.

that later Congresses have seen to it that the restrictive influence of this regulatory tax has remained effective.

The federal law of 1886 was promptly attacked in the courts as an unconstitutional delegation of legislative power. The Supreme Court upheld the law, however, with the statement: "The Act before us on its face is an act for levying taxes, and, although it may operate in so doing to prevent deception in the sale of oleomargarine as and for butter, its primary object must be assumed to be the raising of revenue."[4] This line of reasoning—in which the Court disclaims an interest in motives—has marked practically all decisions on margarine taxation.

Passage of the federal law eliminated whatever small and irresponsible manufacturers may have been engaged in the industry. It was not difficult to collect the $600 annual license fee and the two cents per pound product tax from the larger established manufacturers.[5] There was some evasion of license taxes among the wholesalers, however, and a great deal among retailers. The latter caused the chief problem, just as they had before enactment of the law. The year after passage of the Act, the Commissioner of Internal Revenue urged a reduction of dealers' license taxes to one-fourth their established rate, on the theory that this would reduce evasion and make possible a closer check on retail practices.[6]

In 1902, after continued dissatisfaction with its administration, the original federal law was amended. The amendment increased the tax from 2 to 10 cents per pound on "oleomargarine," but it imposed a tax of one-fourth cent

[4] *In re* Kellock. 165 U. S. 526.

[5] A concentration of margarine manufacturers in relatively few large units has remained a characteristic of the industry. In addition, reduced perishability of the raw products and low processing costs helps the margarine industry attain the competitive position feared by the butter sellers.

[6] U. S. Commissioner of Internal Revenue, *Annual Report,* 1887, p. CXXXIII.

per pound on "oleomargarine free from artificial coloration that causes it to look like butter of any shade of yellow." The purpose of this provision was to justify the claim that the object of the law was to prevent fraud. Uncolored margarine was practically unknown at the time, however, and even the manufacturers were doubtful that it could be sold. The 10 cent tax practically killed the sale of the colored product. Total production dropped by two-thirds in the few years following 1902. The industry adopted the expedient of inserting color in the package for home mixing, but this has never become popular with the public.

The 1902 amendment was tested in the courts and upheld in the Supreme Court in 1904.[7] In this decision it was maintained that the discretion of Congress could not be controlled or limited by the Court because the latter might deem the incidence of the tax oppressive or even destructive. Constitutionality did not make the law enforceable, however. Repeatedly, the Commissioners of Internal Revenue called attention to the difficulty. In 1911, for example, one urged that the tax be changed to a flat rate of two cents a pound. He also recommended that the package and stamp laws used in taxing tobacco be copied.[8]

Despite repeated urgings, the law was not changed in accordance with the Commissioner's recommendations. Minor revisions of the federal laws were made in 1918, 1930, and 1933, but these did not meet the Commissioner's recommendations for application of the tobacco tax techniques and for a reduction in the rate of the tax. It has been pointed out that a tax involving stamps on the package reaching the consumer would wipe out fraud. Dairymen opposed such a stamp tax, since the elimination of fraud

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[7] *McCray* v. *United States*, 195 U. S. 27.

[8] U. S. Commissioner of Internal Revenue, *Annual Report*, 1911, p. 19.

would remove one of the best arguments masking the real demand for restrictive legislation.[9]

The most significant revision was made in 1931, when the restriction on color was made more stringent. Under the 1902 amendment manufacturers were able to impart a degree of yellow coloring by the use of certain oils. The 1931 amendment provided that all margarine would be held yellow in color and subject to the tax of 10 cents per pound when it has a tint or shade containing more than one and six-tenths degrees of yellow or of yellow and red collectively.[10] This amendment even eliminated the use of oils naturally yellow in color in the manufacture of margarine. It is significant because it marks the only known instance in which Congress has granted to an industry (butter) a monopoly of color.

The 10-cent per pound tax has made the sale of colored margarine prohibitive. The motives behind this legislation are illustrated by one incident in the hearings held by the Senate Committee on Agriculture. The original bill contained a provision (not adopted) requiring that all margarine be packed in distinctive wrappings. In support of the provision a dairy representative, C. W. Holman (Secretary of the National Cooperative Milk Producers Federation) stated: "It is a still further effort toward the idea of preventing this product from creating competition."[11]

To round out the picture of restrictive federal fiscal policy, it should be noted that margarine is subject to the same customs duty as butter; both pay 14 cents a pound. The disparity in burdens is marked, in view of price differences.

The federal taxation of margarine, judged by its back-

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[9] W. R. Pabst, Jr., *Butter and Oleomargarine*, p. 35.
[10] U. S. 71st Congress, 3rd Session, Public No. 876.
[11] U. S. 57th Congress, 1st Session, Public No. 110.

ground and the history of its development, points clearly to the conclusion that an extraordinary use of the federal taxing power is involved. Revenue considerations have been insignificant. Nor has there been any link to connect it with such recognized economic goals as aid to underprivileged groups or conservation. Congress, in this instance, has repeatedly been willing to lend the taxing power to a powerful group to aid it in suppressing competition. Fortunately, this has rarely been a factor in federal fiscal policy.

State Restrictions

The principle of preventing competition has been carried much further in state legislation than in federal statutes, for we meet in the states not only restrictive legislation but barriers to shipments across state lines as well. While some representatives of the dairy industry were vigorously proclaiming before Congressional committees that they were quite willing to permit the sale of margarine, providing it was not colored yellow, they were actively engaged in the promotion of state legislation designed to prohibit the sale of the uncolored product also. Before surveying tax barriers in the states it must be remembered that there are at least three important types of non-tax barriers. Twenty states prohibit the use of margarine in state institutions, 31 bar the sale of colored margarine, and many more impose a substantial number of restrictive requirements regarding labeling and packaging.

Among tax barriers there are some state license levies that can be traced back to the period prior to 1900. Concerning the modern excise type, the states of Washington and Oregon had passed laws as early as 1924 prohibiting the use of dairy products in margarine made of vegetable

oils. Since margarine cannot be manufactured without the use of milk, this amounted to a virtual prohibition. Both laws were submitted to a popular referendum and repealed. The next year, Wisconsin passed a similar law which was declared unconstitutional by the State Supreme Court. In the same year, California enacted a margarine tax of two cents per pound which was also repealed by popular referendum. These early defeats show that prior to 1929 state legislation was only moderately restrictive.

Utah's tax of 5 cents a pound on uncolored margarine and 10 cents a pound on colored margarine, passed in 1929, marks the beginning of the really effective and intensive drive to eliminate the product by state taxation. This was followed by a similar tax in Idaho, by a tax of 5 cents per pound on all kinds of margarine in Iowa, a tax of 10 cents per pound in North Dakota, South Dakota, Oklahoma, and Tennessee, and a tax of 15 cents per pound in Washington. All were enacted in 1931. In 1932, Wisconsin taxed all margarine 6 cents per pound and raised the rate to 15 cents in 1935. At present, there are 30 states levying such taxes; nine of these attack all margarine. Notable omissions include Illinois and the state of New York. Most of the 30 states and several others also imposed license taxes on manufacturers, wholesalers, and retailers of margarine.

Motive of Restriction

There is nothing in the history of any of these state levies which leads me to believe that there were any motives other than the elimination of margarine as a competitor of butter. The report of the South Dakota Tax Conference, held in 1931, is a typical example. It states:

> The South Dakota farmers and dairymen are developing a great dairy industry which should be encouraged and protected in every legitimate

way. The use of substitute dairy products, such as oleomargarine, limits the use and lowers the market for butter. . . . A tax of 10 cents per pound on butter substitutes will afford a measure of protection to the dairy interests and at the same time protect the general public from the use of substitutes inferior in every way to pure South Dakota butter. . . . This tax will operate to the benefit of the dairy industry in reducing the amount of such substitutes used, or, if the sale of butter substitutes is not curtailed, will be a fair revenue producer. As between the two possibilities, we would prefer that it operate in a reduction of the use of butter substitutes.[12]

One is inclined to wonder how this mass of restrictive taxation, its motivation clearly defined, has received Supreme Court sanction. It seems fair to conclude that any margarine statute which is properly worded will be acceptable, even if the effect of the tax is to bar the product from the state.

Arguments for Margarine Taxes

The drive for margarine taxes has brought out very peculiar arguments. One of these is that margarine is inferior to butter as a food and should therefore be taxed. Inferiority is by no means demonstrable but, assuming it exists, this is an unusual basis for taxation. It would justify the heavy taxation of Ford cars since they are inferior to Rolls-Royces. Another reason was urged in support of the Washington tax. There they stated that every pound of butter produced in that state paid a tax of 22½ cents. Since margarine was a "foreign" product produced outside the state and paid no taxes, a special tax was necessary to equalize the difference. This line of reasoning, carried to its logical conclusions, would produce very complicated tax problems. One further argument, to the effect that competition must be "equalized," is worth noting. This is perhaps best illustrated by

[12] South Dakota, Division of Taxation. *Bulletin* No. 14, p. 14. Quoted in *Barriers to Internal Trade in Farm Products,* U. S. Bureau of Agricultural Economics.

the following statement circulated by a dairy organization seeking additional federal taxes:

> The National Cooperative Milk Producers' Federation is asking the Congress of the United States to impose an additional federal tax of five cents per pound on all oleomargarine manufactured and sold in this country. This tax, if enacted, will strike at the root of the competitive problem which is facing dairy farmers and will go far toward solving their oleomargarine problem. The effect of the tax will be to reduce the amount of the price spread and thereby to more nearly equalize the competition between butter and oleomargarine.[13]

Although it is never openly pressed, the butter producers have in effect argued that margarine should be taxed because butter does not have a monopoly of the market. As an argument, the health factor is now rarely mentioned, since there is little evidence regarding the undesirability of margarine. This is especially true since vitamin A has been introduced into the product.

The effort of the dairy interests to outlaw margarine by state taxation led to an interesting development in those states producing the raw materials for margarine. Efforts are made to force the consumption of some particular fat or oil among the many from which the product can be processed. In 1931, Nebraska and Wyoming adopted laws taxing all margarine except that containing a certain percentage of animal fats. In 1933, 1934, and 1935, 13 additional states adopted taxes on margarine, exempting that manufactured from certain ingredients, principally those produced in the home state. These laws were designed to backfire against margarine taxation which was sweeping the country. They nullified the dairymen's argument that margarine should be taxed because it was made in part of imported oils. Further, they gave to local interests a measure of

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[13] National Cooperative Milk Producers' Federation, *Oleomargarine—Friend or Foe of the South,* pp. 21-2.

protection in the fast-dwindling market for margarine. From the standpoint of taxation, of course, these laws were no better than the taxes on all margarine sponsored by the dairy interests, who, naturally, vigorously opposed the passage of these trade barrier levies. It is with respect to these levies that the states are justly criticized for having gone into the tariff business.

States that produce cottonseed oil and which feel bitterly against dairy areas for their sponsorship of margarine taxation are beginning to think of retaliatory taxes. In 1939 there was introduced in the Arkansas legislature a bill providing for a 25 per cent ad valorem levy on the dairy products of Washington, Wisconsin, Iowa, and Minnesota.[14]

Economic Effects of Margarine Taxation

Although difficult to trace with accuracy, the taxation of margarine has had many undesirable economic effects. In general, it can be said that the state taxation of margarine has not fulfilled either of the alternative expectations of the South Dakota Tax Conference, that is, protection of the dairy industry or the production of revenue.

Revenue

As revenue producers, state margarine taxes have been conspicuous by their failure. Only one state, Pennsylvania, collects any appreciable amount of revenue from this source, and this from license taxes first enacted in 1899. As would be expected, states taxing margarine of a particular raw material content collected no revenue at all from such taxes. Manufacturers selling in these states simply made their product conform to the exemption and did business freely.

Data on yields from margarine taxes are set forth in

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[14] Arkansas H. B. No. 37 (1939).

Table 1. Among those states taxing all kinds of margarine, North Dakota and Washington obtained no revenue. Wisconsin obtained \$19.72, South Dakota \$20.00, and Oklahoma \$52.00. Only Iowa received a significant amount of revenue from a tax on all margarine, namely, \$78,959.90. During 1939, the year for which these yields are noted, only three states, Iowa, Utah, and Pennsylvania, got as much as one-tenth of 1 per cent of their total revenues from this source. In another recent compilation somewhat different figures are presented, but again the yields are shown to be generally insignificant.[15]

Butter Prices

There is little evidence that dairymen have obtained any benefit from state taxes on margarine. The price of butter, of course, is set in a national market, and all of the states imposing general margarine taxes are surplus butter producers. Local prices are determined primarily by production and marketing conditions. A combination farm price for dairy products, weighted by the volume sold in various forms, reveals that prices tend to be lowest in those states which tax all margarine. In Wisconsin, the Dakotas, and Idaho, this fact is most marked. This suggests that, where conditions bring about a low butterfat price, efforts to improve prices include unsuccessful recourse to margarine taxation.

Margarine Consumption

There are meager data on margarine consumption by states, but the effects of state taxation, coupled with that of the less significant non-tax barriers, on the sale of margarine can be illustrated by an examination of the number

[15] Tax Policy League, *Tax Yields: 1939*, pp. 42, 111.

TABLE 1

REVENUE DERIVED FROM STATE OLEOMARGARINE TAXES AND LICENSE FEES FOR YEAR ENDING DECEMBER 31, 1939

State	Revenue from Per Pound Tax	Revenue from License Fees	Total Revenue
Alabama	$ .00	$ ..	$ .00
Arkansas	.00	..	.00
California	..	60,245.28	60,245.28
Colorado	.00	500.00	500.00
Connecticut	..	6,959.00	6,959.00
Florida	.00	..	.00
Georgia	.00	..	.00
Idaho	417.00	260.00	677.00
Iowa	78,959.90	..	78,959.90
Kansas	.00	..	.00
Louisiana	.00	..	.00
Maine	.00	..	.00
Minnesota	.00	1,282.00	1,282.00
Mississippi	[a]	[a]	[a]
Montana	[a]	[a]	[a]
Nebraska	.00	2,856.00	2,856.00
New Mexico	.00	..	.00
North Carolina	[b]	[b]	2,500.00[b]
North Dakota	.00	.00	.00
Oklahoma	20.00	32.00	52.00
Pennsylvania	..	355,830.00	355,830.00
South Carolina	[c]	..	[c]
South Dakota	20.00	..	20.00
Tennessee	[b]	[b]	9,072.40[b]
Texas	.00	..	.00
Utah	16,118.21	1,270.00	17,388.21
Vermont	..	8,675.02	8,675.02
Washington	.00	..	.00
Wisconsin	18.72	1.00	19.72
Wyoming	.00	..	.00

Source: Institute of Margarine Manufacturers. Data obtained by letter of inquiry directed to each state.

[a] No response to inquiry.
[b] Tax and license combined.
[c] No data available.

of retail margarine dealers in each state. The number of such dealers, for the fiscal years 1928 and 1939, is shown in Table 2. The year 1928 was chosen because it preceded the enactment of most of the state taxes. The latest year for which data are available is 1939.

In states having excise taxes on all margarine the number of retail dealers decreased 87 per cent. In Idaho, Washington, and Wisconsin the reduction has been 100 per cent. Some of these states also have license taxes, but it is difficult to determine the exact effect of such licenses. For example, Washington and Wisconsin both have an excise tax of 15 cents per pound. Wisconsin has an elaborate system of license taxes, even a license tax of $1.00 on the consumer, while Washington has no license taxes. All retail margarine dealers have been eliminated from both states.

TABLE 2

NUMBER OF RETAIL DEALERS LICENSED TO SELL UNCOLORED MARGARINE, 1928 AND 1939

STATES HAVING EXCISE TAX ON ALL UNCOLORED MARGARINE

State	Tax (cents per pound)	Number of Retail Dealers		Per Cent Change
		1928	1939	
Idaho	5	699	0	−100.0
Iowa	5	7,400	2,302	− 68.9
Utah	5	733	255	− 65.6
North Dakota	10	764	1	− 99.9
South Dakota	10	1,523	27	− 98.2
Oklahoma	10	2,363	404	− 82.9
Tennessee	10	3,498	317	− 90.9
Washington	15	3,986	0	−100.0
Wisconsin	15	5,007	0	−100.0
Total		25,973	3,303	− 87.3

In the states taxing margarine not containing a specified percentage of animal fats (Table 3), retail dealers have declined 43 per cent. The animal fat requirement limits sales to those few manufacturers making an animal fat product, with the result that the market is probably not as thoroughly exploited as in states where competition is general. Also,

there are a number of people who, for aesthetic or religious reasons, do not purchase an animal product.

TABLE 3

STATES HAVING EXCISE TAX ON MARGARINE NOT CONTAINING SPECIFIED PERCENTAGE OF ANIMAL FATS

State	Tax (cents per pound)	Number of Retail Dealers		Per Cent Change
		1928	1939	
Minnesota.............	10	5,416	1,816	−66.5
Nebraska..............	14¾	3,410	2,986	−12.4
Wyoming...............	10	275	351	+27.6
Total...............		9,101	5,153	−43.4

The number of retail dealers in states taxing margarine not made of specified domestic oils (Table 4) has shown a marked increase of 73 per cent. Such taxes, of course, do

TABLE 4

STATES HAVING EXCISE TAX ON MARGARINE EXCEPT THAT MADE OF SPECIFIED DOMESTIC OILS

State	Tax (cents per pound)	Number of Retail Dealers		Per Cent Change
		1928	1939	
Alabama...............	10	1,389	2,615	+ 88.3
Arkansas..............	10	1,432	2,159	+ 50.8
Colorado..............	10	2,362	2,431	+ 2.9
Florida...............	10	2,288	5,160	+125.5
Georgia...............	10	1,601	3,339	+108.6
Kansas................	10	7,278	5,310	− 27.0
Louisiana.............	12	1,602	2,831	+ 76.7
Maine.................	10	1,435	2,165	+ 50.9
New Mexico............	10	194	628	+223.7
North Carolina........	10	821	2,846	+246.6
South Carolina........	10	432	1,751	+305.3
Texas.................	10	2,341	8,735	+273.1
Total...............		23,175	39,970	+ 72.5

not interfere with the sale of margarine so long as it is made of certain ingredients. The increase in retail outlets (and sales) in these states may be accounted for by several factors.

1. In 1928, these markets had not been covered as thoroughly as the more heavily populated states nearer the manufacturing centers.
2. Being barred from a number of states by taxation, manufacturers have concentrated their sales effort in these areas.
3. The controversy over margarine legislation, centering around products produced in these states, has resulted in considerable publicity and called the product to the attention of an increasing number of consumers.

The data on states having retail license taxes (Table 5) but no excise tax are not easily analyzed. Some of these license taxes were adopted as early as 1899 and a "before and after" analysis cannot be made. Generally, it can be said that the imposition of a retail license tax checks, if it does not reverse, the normal expansion of sales.

TABLE 5

NUMBER OF RETAIL DEALERS LICENSED TO SELL UNCOLORED MARGARINE, 1928 AND 1939
STATES WITH NO EXCISE TAX BUT LICENSE TAX ON RETAILERS

State	Annual Retail Tax (dollars)	Number of Retail Dealers		Per Cent Change
		1928	1939	
California[a]	5	12,236	12,348	+ 0.9
Connecticut	6	899	812	− 9.7
Mississippi[b]	10	302	666	+120.5
Montana	400	300[c]	32	− 89.4
Pennsylvania[d]	100	4,177	4,332	+ 3.7
Vermont	25	196	423	+115.8
Total		18,110	18,613	− 2.8

[a] Tax adopted in 1923.
[b] Repealed in 1940.
[c] Average 1922–24; tax adopted in 1925.
[d] Tax adopted in 1899.

In states which imposed neither excise nor retail license taxes (Table 6), there has been an increase of 10 per cent in the number of retail margarine dealers during the 11-year period. These states represent markets which were pretty well developed before 1928, and the rate of expansion since that time may be considered "normal."

TABLE 6

STATES HAVING NO TAXES ON MARGARINE

State	Number of Retail Dealers		Per Cent Change
	1928	1939	
Arizona	531	1,031	+ 94.1
Delaware	341	425	+ 24.6
District of Columbia	443	983	+121.9
Illinois	15,436	15,535	+ 0.6
Indiana	10,306	9,536	− 7.5
Kentucky	1,954	4,367	+123.5
Maryland	1,958	3,282	+ 67.6
Massachusetts	4,629	4,192	− 9.4
Michigan	10,516	11,797	+ 12.2
Missouri	6,986	8,750	+ 25.3
Nevada	63	140	+122.2
New Hampshire	699	991	+ 41.8
New Jersey	5,817	4,756	− 18.3
New York	13,986	12,272	− 12.3
Ohio	16,298	16,136	− 1.0
Oregon	2,530	2,735	+ 8.1
Rhode Island	604	885	+ 46.5
Virginia	1,824	4,012	+120.0
West Virginia	2,094	4,562	+117.9
Total	97,015	106,387	+ 9.6
Total, United States	173,079	173,426	

Source: U. S. Commissioner of Internal Revenue. *Annual Reports*, 1928 and 1939.

It is apparent that the excise tax applied to all margarine, regardless of ingredients, is a most effective deterrent to sales. If the rate is high enough, the tax is equivalent to prohibition. The tax on margarine not containing animal

fat is the next most effective in reducing sales, followed by the license tax on retail dealers. The tax on margarine not made of domestic ingredients is no deterrent to margarine sales.

Conclusion

Chief losers in this struggle to eliminate competition by taxation are consumers and the producers of raw materials used in margarine. Losses to both groups cannot be measured accurately. Since the product taxed is desired chiefly by low income groups such burdens as are shifted to consumers are regressive. The particular importance of margarine to the poorer classes suggests that its being singled out for taxation involved an unfortunate tax effort which penalizes low income groups.

When unable to purchase margarine, do consumers purchase equal quantities of some inexpensive alternative or do they reduce fat consumption by purchasing smaller quantities of butter or by going without either product? There are no studies which answer these questions. All that is definitely known is that consumers are overwhelmingly opposed to this form of taxation. On ten occasions the public has had an opportunity to vote on this question in state referenda. Eight times it has voted to repeal margarine taxes enacted by the legislatures. The two exceptions were in Oklahoma, in 1932 and 1938, and it is rumored that in this state the dairy interests and the bootleggers of margarine united to oppose repeal of the tax.

Producing groups affected by margarine taxation are the agricultural producers and processors of fats and oils. (Table 7 shows the raw materials used in margarine during the past fiscal year.) Cottonseed oil and soybean oil, both products of domestic agriculture, head the list. Ironically,

milk is not far behind. There appears to be a ratio of five parts of fat to one of milk in most American processes. The taxation of margarine, therefore, cuts squarely across American agriculture. It has arrayed one group against another. All producers of fats and oils are affected.

TABLE 7

MATERIALS USED IN MANUFACTURE OF OLEOMARGARINE

(Colored and Uncolored)

Year Ending June 30, 1940

	Pounds	Percentage of Total
Babassu oil	11,360,570	3.596
Beef fat	31,600	.010
Butter	188	.00005
Butter flavor	1	.0000003
Coconut oil	26,270,696	8.315
Color	1,447	.00045
Corn oil	53,339	.017
Cottonseed oil	102,056,918	32.304
Cottonseed stearine	13,365	.004
Derivative of glycerine	771,679	.244
Lecithin	83,223	.026
Milk	58,622,534	18.556
Neutral lard	3,197,002	1.012
Oleo oil	11,889,139	3.763
Oleo stearine	3,178,037	1.006
Oleo stock	1,018,790	.322
Palm oil	4,446	.00140
Peanut oil	2,137,756	.677
Salt	12,769,389	4.042
Soda (benzoate of)	118,416	.037
Soya bean oil	82,331,741	26.060
Soya bean stearine	2,200	.00069
Vegetable gum	1,762	.00055
Vitamin concentrate	15,638	.005
Total	315,929,876	99.999

Source: Commissioner of Internal Revenue. *Monthly Reports*

By means of taxation, margarine consumption in the United States has been held at or below 3 pounds per capita. By comparison, pre-war per capita consumption

in the United Kingdom was 8 pounds; in Germany, 18 pounds; and in Denmark, 46 pounds. If permitted to sell freely, there is good reason to believe that consumption in this country might approximate 8 to 10 pounds per capita annually. Such an increase would involve the consumption of an increment of three-quarters of a billion additional pounds of fats and oils, obviously an important factor in a market now showing the largest supplies on record.

From the point of view of fiscal policy, margarine taxation has little to commend itself. Its incidence is regressive, in that direct and indirect burdens fall heaviest upon the elements of our population least able to pay. As far as the states are concerned, such taxation fails as a revenue producer. It has adversely affected the manufacture, flow of trade, and consumption of a commodity against which there is no socially supported reason for the suppression of non-fraudulent sales. Finally, it is a dangerous precedent for taxes sponsored by pressure groups. They distort competitive relationships without bringing compensating benefits to the general public.

CHAPTER IX

REASONS FOR FARMER SUPPORT OF OLEOMARGARINE TAXATION

ERNEST M. WRIGHT

Field Secretary, Iowa State Dairy Association

As a matter of information, I wish to explain that the Iowa State Dairy Association is made up of twelve producer, processing, and labor groups, all vitally interested in the dairy industry. Each of these twelve groups is state-wide in character and has one vote on all matters of policy or finance. Any action by the association requires a unanimous vote. Because of this rule, it is impossible for me, as field secretary, to state today just what the dairy interests of Iowa might be willing to do regarding any changes in the present oleomargarine laws.

I shall attempt to tell you, however, why the oleomargarine tax was so actively supported by our association. Prior to 1920, about the only regulations on oleomargarine in Iowa were the laws prohibiting its sale in the place of butter, the same as in other states. In 1922, however, the oleomargarine people launched an advertising program which was particularly obnoxious to the dairy people. I wish to show you an advertisement which appeared in the *Des Moines Evening Tribune,* March 15, 1922.

This naturally stirred the ire of the dairymen, and in 1926 a bill was introduced in the Iowa legislature calling for a half-cent tax as an inspection fee on oleomargarine.

Cow

Alice Pontiac Hengerveld de Kol is one of the thoroughbred cows on the famous Jelke Farm in the Elgin district of northern Illinois. Milk from inspected cows only is used in churning Jelke Good Luck Margarine.

MILK FROM INSPECTED COWS

Jelke Good Luck Margarine is churned in full cream milk from this valuable thoroughbred and from thousands of other selected cows.

Infinite care is taken with their selection and feeding to produce milk that is richest in butter fats and proteins.

This splendid grade of full cream milk used in churning Good Luck imparts the delicious flavor—makes it nutritious—and supplies the vitamines that are always present in Good Luck.

When you spread bread with Jelke Good Luck you enjoy the wholesome goodness of full cream milk. Use more Good Luck. For sale at your dealer's at a price that all can afford.

GOOD LUCK
MARGARINE
JELKE
The Finest Spread for Bread
Wholesale Distributor

Lady

HARRY GOLDMAN & VIELE, INC.
201 West Court Ave.
Des Moines, Iowa

The bill did not even get a hearing. It was reintroduced in the next legislature in 1928, but this time it called for a one-cent tax. It passed the House unanimously and was killed in the Sifting Committee of the Senate. The bill was again introduced in 1930, this time calling for a five-cent tax. It passed the House and Senate with only one vote against it in the Senate. The principal arguments of the dairymen in supporting this measure were:

1. Seventy per cent of all ingredients used in the manufacture of oleomargarine were imported or foreign oils.
2. This product came in direct competition with butterfat, and it was impossible for our Iowa farmers to compete on a price basis with the cheap imported fats.
3. The state government had the responsibility of inspecting and supervising the sale of oleomargarine, and therefore this expense should be borne by the industry.
4. The five-cent tax would bring in some revenue to the state of Iowa. That the law has succeeded is entirely a matter of record. As a

revenue measure from 1931 to 1939 inclusive, a total of $1,490,-516.05 has been collected from oleomargarine taxes.

5. Oleomargarine manufacturers used unfair advertising in promoting the sale of their product.
6. The dairy industry paid many taxes on cows, plants, trucks and equipment, and the oleomargarine interests should pay their fair share of state government.
7. The price of oleomargarine follows the price of butter more closely than it does the cost of the ingredients of oleomargarine.

We all know that oleomargarine manufacturers have continually changed their formulas. The federal import duty of three cents a pound placed on edible coconut oil in 1934 has served to curtail, to some extent at least, the use of this product in oleomargarine. The low price of cottonseed oil about the middle of the last decade has naturally encouraged the use of this oil.

The most recent development is an astounding increase in the use of soybean oil. In 1933 only 7,000 pounds of soybean oil were used in the manufacture of oleomargarine, whereas in 1939 more than 82,000,000 pounds were used. From these facts it is quite apparent that the oleomargarine manufacturer can use practically any of the oils, and uses those that are the cheapest, regardless of their origin. The truth of the matter is that the farmers who produce the fat which goes into oleomargarine receive virtually nothing for their product.

To illustrate, I wish to cite a personal case. I live on and operate a 120-acre farm near Waterloo, Iowa. The average yield of soybeans in Iowa this year was 20 bushels, and on November 10 the price was 73 cents a bushel. If I had taken 20 bushels of soybeans to the processing plant on that date, I would have received $14.60. Out of each bushel of beans, the manufacturer makes approximately 45 pounds of soybean oil meal and 8 pounds of oil. So out of the 20

bushels of beans the manufacturer makes 900 pounds of soybean oil meal and 160 pounds of oil.

The livestock farmer is the only person who can use the meal to any great extent. Had I purchased that 900 pounds of soybean oil meal on the same date, it would have cost me $1.70 a hundredweight, or a total of $15.30, and of course I would have had to pay the trucking both ways, plus the 70 cents additional charge for the meal in excess of what I received for my beans. Now let me ask you, "What did this manufacturer pay me for the 160 pounds of oil?" Please understand, I am not criticizing the processors of soybeans. They receive only about 4½ cents a pound for the oil, and must pay all processing costs, overhead, freight, and try to make a profit. But this oil must of necessity compete on a price basis with imported fats and oils.

According to Dr. C. Y. Cannon of Iowa State College, there is no apparent advantage in feeding soybean oil meal to dairy cows as compared to cracked soybeans. In fact, he states that there seems to be some benefit to the cow in favor of the cracked soybeans over the soybean oil meal.

As a farmer, I am not "married to my dairy cows." If you can show me how I can make a living on my 120 acres by growing soybeans and selling oil, I shall be very happy to make the change, and other millions of dairy folks throughout the land will be glad to do the same thing. As a farmer, again, I wish to ask you, "How do you propose that I maintain my soil fertility under such a program? What do you propose to do with cottonseed meal, soybean oil meal, etc., if the dairy cow is eliminated? Are you sure the oleomargarine manufacturer can produce a suitable spread for bread at present prices when he has to pay the farmer a reasonable price for the oil?"

According to the Bureau of Economics, U. S. Department

of Agriculture, we consume in this country annually about eight billion pounds of fats and oils. Approximately six billion pounds of this are produced in America, and the other two billion pounds are imported. The trouble with most of this six billion pounds of domestic oils and fats is the low price. I believe everyone in this room is willing to agree that the farmer is entitled to a fair price for this fat. Due to the interchangeability of most of these oils, the domestic price is set in the world market. Except in the case of butterfat, most oils or fats are by-products, and, as such, the farmer has little or no knowledge of what he gets for his fat or oil.

For this reason, it has been difficult to rally the farmers of America to the point of actually doing something about the imported fats and oils—all imported fats and oils—that which goes into soap as well as that which goes into oleomargarine. Personally, I believe that if the users of fats and oils in America will consent to substantial increase in the import duty on all fats and oils that are imported into this country, it would be entirely possible to get all farmers, including dairymen, to agree on some common, sensible program. But we insist that before we trade horses in the middle of the stream, we at least see the color of the other horse.

There may be other requirements that the dairy people will insist upon, if any changes are to be made. First, oleomargarine manufacturers must be prevented from using any dairy terms in their advertising. Secondly, yellow color is the natural trade-mark of butter, and its use should not be permitted in advertising oleomargarine. Perhaps some people think the dairy industry is unjustly and unnecessarily concerned about the policies and sales promotion schemes of the oleomargarine manufacturers. As proof of

the justifiability of this opinion, we cite the action of the Federal Trade Commission earlier this year when they ordered one of the leading manufacturers of oleomargarine to cease immediately and desist from: (1) use of the words "churn," "churned," "sunlit churnery," or any other derivative of the word "churn," or the picture of an old-fashioned dasher churn, or any words or pictures implying that its product has been churned through the process by which butter is made from milk or cream in describing its product or process; (2) use of the terms "fresh pasteurized milk" or other terms which do not clearly reveal that the milk so designated is not whole milk, to refer to milk used by the respondent in manufacturing its product when the milk so used is other than whole milk; (3) using the word "milk" to describe that part of milk remaining after any part of the cream or butterfat has been removed, unless the word "milk" is qualified by words clearly revealing that the "milk" referred to is not whole milk but "skimmed milk"; and (4) representing that its product contains 43.8 per cent or any other percentage more "milk solids" than butter or any other spreads for bread; that the product contains any appreciable quantity of "milk solids"; that the food value of the product is attributed to the "milk solid" content thereof, or that this content gives it more food value than butter.

In conclusion, I contend that the market for fats and oils is basic and fundamental to practically all branches of agriculture in America today. Even though most fats are largely by-products, the farmer is entitled to a fair price for each and every pound he produces, whether from cotton, soybeans, or hogs, up to the full extent of the American market to use that fat, without undue competition of imported fats and oils.

Furthermore, until the proper legislation is passed by Congress to guarantee to the dairy farmers of America fair competition and fair advertising of all competing products, and that all competing products of the dairy industry are produced under wage scales and standards of living prevailing in the United States, the dairy industry will continue to lend its whole-hearted support to such measures as excise taxes on oleomargarine.

CHAPTER X

THE TRADE-BARRIER CHARACTER OF OLEOMARGARINE TAX LAWS

CHARLES H. JANSSEN

President, National Association of Margarine Manufacturers

THE issue of *Taxes for Democracy,* dated October 23, 1940, had as its subject the question "What Are Tax Barriers to Trade?" It gave the following definition, referred to as having been suggested by a committee of the Tax Policy League planning the program of this symposium: "A tax barrier to trade is any form of taxation or administrative practice in taxation which tends to interfere with the normal flow of trade across city, state, or national boundaries." In amplification, it was added:

It is recognized that almost any tax will have some effect upon trade, but attention will be directed in this symposium to those taxes that have a direct restrictive effect upon the movement of goods across governmental barriers.

The term interstate commerce has become a legal concept which is confusing to the layman. When he thinks of interference with trade, he does not wish to be bothered with the legal technicality of whether goods "come to rest" for a few days or weeks and thereby escape the category of interstate commerce. What he is concerned with is whether the buyer is artificially diverted from one market to another by reason of a particular tax.

The League invited readers to send in other definitions, and in response to that invitation I offered the following: "Any form of taxation or administrative practice pursuant thereto, which purposes or tends in effect to restrict, sup-

press, or mitigate the normal consequences of fair and open competition in commerce, or tends to establish artificial economic barriers to fair and open competition in commerce, for or against a legitimate product, or any legitimate service factor therein, is an unfair barrier to trade." This, in my opinion, is a comprehensive definition, by which not only such classic barriers to trade as the oleomargarine tax laws, but every type of interstate trade barrier law, is condemned.

This definition gets at the peculiar and undesirable essence in measures declared to be revenue measures, wherein the expressed purpose of raising revenue for the state is but a cloak to cover an intent to stifle competition. I pointed out that there may be tax laws of the same general character as those condemned as harmful trade barriers, which in motive, purpose, and effect are wholly constructive and in the general public interest, but without essentially disturbing the balance between free trade and controlled competition. But I understand that "there can never be any identity between a real revenue measure and a trade barrier" and that "Hence, there cannot be laid at the door of those interested in revenue production the laws which tend to make for trade barriers."[1]

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[1] (a) "The number of barriers that have been put up because of taxation is relatively few, and I should like to discuss some of them briefly with you. From one end of this nation to another, there are a large number of laws which have for their objective the barriers that you are considering here as detrimental to trade. The very fact that they undertake to set up barriers indicates on their surface that they are not tax laws, because a revenue measure has for its essential the annual recurring creation of capital in the form of taxation or taxes to support government, while these barrier laws have for their objective the drying up of the particular thing which it is sought under the law to tax. So there can never be any identity between a real revenue measure and a trade barrier. . . .

"By way of illustration, the mere fact that there is a tax laid in the form of a fee or license on oleomargarine is, in the very essence, an indication that it is not a tax measure, because the objective of it is perfectly clear; namely, to discourage the use of oleomargarine so that butter will be more generally employed by the people. If it were a revenue law you couldn't rely upon it, because the object of the particular enactment was to destroy that particular

The oleomargarine laws of the various states impose excise and license taxes. Labeled as revenue measures, and enacted as such, they also differ from the real revenue measure in that their enactment was the special object, not of tax officials charged with the duty of raising revenue, but of certain organized agricultural or commercial interests, or both, commonly called "pressure groups."[2]

That the oleomargarine tax laws resulted from the pressure of such special private interests, and that their real purpose is to suppress trade in the article taxed, is well supported by incontrovertible evidence. I shall present samples of such evidence, but first, let it be understood that oleomargarine is a wholesome, palatable, economical food product, made from wholesome fats and oils, constituents of cows' milk and salt, which are consumed in one form or another in other food products all over the world. The ingredients and the finished product, like all other food products sold in the American market, are certified as to their

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commodity, oleomargarine." Henry F. Long, *Proceedings* of the National Conference on Interstate Trade Barriers, pp. 67-74.

(b) At a Hearing on Agricultural Barriers, held by the Temporary National Economic Committee at Washington, D. C., March 17, 1940, the following exchange took place:

Acting Chairman Pike. "You don't think, then, there is any reality behind the claim that these laws are for the purpose of revenue?"

Mr. Janssen. "I do not."

Acting Chairman Pike. "I think that is fair enough; I don't think anybody else does."

[2] "One of the great dangers in a democracy lies in the power that can be exerted by organized minorities or temporary pressure groups. The methods that are being pursued by many such bodies partake of blackmail. Legislators and officers of government have demands made upon them that they are told they must meet or they will be defeated for re-election. . . . Pressure groups and organized minorities can—through working together and trading with each other—obtain almost any character of legislation they wish if the people are not alive to what is going on and do not act to prevent . . . In view of the supreme court decision concerning the 'use tax' and the fact that due to the action of pressure groups, more largely than any other cause, trade barriers between states are being raised, it is essential that some way be found to nullify such pressure." Fred L. Kent, *Proceedings* of the National Conference on Interstate Trade Barriers, pp. 49-58.

wholesomeness by the general health and food regulatory laws of the federal and state governments. By virtue of these laws, the consumer is protected against fraud, misrepresentation, and subterfuge in the manufacture, sale, labeling and advertising of food products in general, including oleomargarine. In fact, regulatory food control in the United States, and elsewhere, is accomplished through regulatory law, and not through restrictive or prohibitive tax or revenue measures.

When the federal oleomargarine, adulterated butter, and renovated butter revenue law was passed in 1886, there was no federal food law and there were only four or five state food laws. Most of the advocates of the law in 1886 were honestly trying to enact a purely regulatory law to prevent fraud and deception. Some eminent lawyers in Congress at that time expressed the opinion that food control is a police power which belongs to the states, and cannot be exercised by the federal government. Congressional opinion at this time agreed that desired food control over intrastate commerce could not be exercised by the federal government, except through exercise of its taxing power. Hence, in the absence of general food control laws, Congress enacted a tax measure to establish control over the manufacture and sale of oleomargarine, adulterated, and renovated butter, to prevent fraud and deception in both intrastate and interstate commerce.

With the subsequent enactment and growth of general food and drug regulatory law, such as has finally emerged in the recently enacted federal Food, Drug and Cosmetic Act, and regulations thereunder, the necessity for the original Oleomargarine Act concurrently disappeared, as its original purpose to prevent fraud and to protect the consumer was being guaranteed more effectively under such general regula-

tory law. But the oleomargarine laws, federal and state, continued to stay on the statute books and were, from time to time, made even more stringent. Every effort to repeal or modify them has been bitterly and effectively opposed, and this has led many to assume erroneously that the retention of these laws is essential and in the public interest.

The facts are that certain agricultural and commercial interests believe that the restrictive influence of these laws on commerce in this product holds for them certain commercial and political advantages, which they do not wish to relinquish. The interests of that section of agriculture which produces the commodities for which oleomargarine finds a wider market, or of consumers, who need a low priced table fat, do not enter into the matter at all. The basic motive behind these laws taxing oleomargarine is the suppression of free competition. There is ample evidence to support this assertion.[3]

I have here in my hand a photostatic copy of a letter on the stationery of the National Dairy Union, an organization of allied dairy interests, Washington, D. C., dated January 5, 1925, from which I quote the following:

> If every state in the United States could limit the manufacturer and sale of oleomargarine as much as it is limited in Pennsylvania, for example, there would have been no surplus butter in storage on the first day of November to depress our market from six to ten cents a pound through this winter.
>
> Work which needs to be done includes shutting oleomargarine out of the Army and Navy; preventing use of oleomargarine in state and municipal institutions; stricter enforcement of the laws for protection of patrons of public eating houses; strict enforcement of anti-coloring law; representation for dairy industry in contested oleomargarine cases;

[3] "Experience has shown that while a few minority groups reap the benefits of trade barriers, the great consuming public pays the bill once these barriers have been erected. In fact, these state barriers constitute a subsidy for organized minorities." Lloyd C. Stark, *Proceedings* of the National Conference on Interstate Trade Barriers, pp. 40-48.

careful watch to prevent repeal or invalidation of existing laws; tariffs and health restrictions to prevent importation of materials unfit for use in imitation dairy products; and prevention of false and misleading advertising.

I have a copy of another letter, dated January 12, 1934, over the typed signature of the president of the National Dairy Union who served that year and the personal signature of its secretary at that time, from which I quote:

> The threat of the oleomargarine-cottonseed oil-beef cattle proponents is for the repeal of all "restrictive" oleomargarine legislation. This is explained and answered in the enclosure. They seek a "billion pound market" displacing that amount of butter.
>
> In our judgment any repeal of any part of the federal oleomargarine law would be fatal to this industry. The job of making and selling butter at a profit is hard enough without more oleomargarine!
>
> In the 31 years since the National Dairy Union was organized to protect the oleomargarine law, we have never lost a contest. But we cannot go forward with an empty treasury. We ask you *NOW* to become a member and send us a membership check. *Your help is needed.* Your markets are in danger.

I have another dated October 24, 1936, from the same organization, from which I quote the following:

> This meeting will mark the end of the 35th year of the active work of this organization, its 34th year as an incorporated voice of the butter industry at Washington. It speaks as forcefully today as ever.
>
> All existing federal oleomargarine legislation and all federal import taxes, tariffs, and excise taxes on imported oils and fats are based upon the legislative activity of this organization. . . .
>
> In many states thorough revision of the state oleomargarine laws is needed. In North Dakota there was not a single oleomargarine dealer last year. In Ohio there were 14,400 oleomargarine dealers. The only reason for this is found in the state laws. The federal law applies to all states alike.

I have another dated October 26, 1936, from which I quote:

> With growing consumer consciousness, it is more than likely that the oleomargarine laws, instead of being strengthened from time to time,

would have long since been repealed but for the work of the National Dairy Union.

And yet another, almost down to date. It is dated April 8, 1938, and I quote from it the following:

> *Two more government departments* can buy and serve oleomargarine under amendments to bills passed in the Senate Tuesday, April 15, unless these are killed in conference committee. Your own Congressman should be informed at once. He can be asked to protest to the Conference Committee. You are urged to write him and make this request. . . . Our defences against oleomargarine will slip away rapidly if any of these proposals authorizing government purchases are permitted to stand.
>
> Let me repeat—*Your own Congressman should be informed at once of your opposition. He can, if asked, call on the members of the conference committees. You can write him and make this request.*

Needless to say, the provisos which would have permitted the government of the United States to purchase oleomargarine in these instances, were defeated.

I cite these letters in evidence of the fact that one powerful pressure group, which boasts that it fostered these laws and takes full credit for having kept them effective for at least 35 years, freely admits that while they are drafted as revenue laws and so enacted, they are, in fact, barriers to trade, intended to destroy fair and open competition and have for their sole objective the drying up of trade in the object taxed. This, they have fairly well accomplished.

Let me state in conclusion that, particularly in these latter days, it is highly important that we do not destroy the intimate relationship of democracy in industry and commerce and democracy in our political life.[4] Free, open, and

[4] "This relationship was recognized and given practical expression very early in our national life. Albert Gallatin, for 12 years Secretary of the Treasury under Presidents Jefferson and Madison, an industrialist, owning and operating glassworks in New Geneva, Pa., said this in 1794: 'The Democratic principle upon which this nation was founded should not be restricted to the political processes but should be applied to the industrial operation.' " Donald Despain, in *Nation's Business*, August, 1940.

fair competition in commerce between states is the very essence of both industrial and political democracy. We cannot have one without the other. It is an essential ingredient of our economic system of free enterprise, which we seek to defend against monopolistic and unfair practices in competition. Every law that so clearly purposes the suppression of competition in legitimate private industry and tends to close sections of our consumer markets against sectional products of American agriculture, such as is the case with respect to oleomargarine, is repugnant to that concept, and should be repealed.[5]

---

[5] The Committee on Federal Taxation of the American Institute of Accountants set forth the following basic principles of tax legislation on October 14, 1940: Tax legislation should be designed only to produce revenue on a basis equitable to those of our people who must, ultimately, bear the burden thereof and should not attempt to accomplish social reforms, however desirable they may be.

The prime purpose of revenue laws is to produce revenue to pay for the service of government. When they seek to accomplish other results, both efforts fall short of the mark and neither goal is attained.

But while social reform or control should not be sought through tax legislation, the necessary social and business effect of taxation for revenue only cannot be overlooked. Taxation is a monopoly of government and it is subject, as are all monopolies, to the economic law of diminishing returns, in the form of industrial activity and employment as well as revenue.

Here, then, the form and media of taxation become important. It is with these that this committee proposes to deal, recognizing, as fundamental necessities, these principles:

(1) Tax laws should be designed for revenue purposes only.
(2) They should levy the burden on a basis equitable to all, recognizing ability to pay and benefits received.
(3) They should, so far as possible, encourage rather than deter business activity, production, and employment.
(4) They should be certain and definite, so that business will know its obligation and its liability.
(5) They should follow business practice rather than oppose it.
(6) They should not involve administrative difficulties or lead to dispute and litigation, but should encourage taxpayers' cooperation.

Having in mind the foregoing principles and that the unsettled conditions of the present require not only more revenue but more production, particularly of the means of national defense, this committee submits twenty-five recommendations listed in detail in the contents page of this report.

CHAPTER XI

VARIATIONS IN TOBACCO TAX RATES AND THEIR RESULTS IN PRODUCING TRADE BARRIERS

C. S. Logsdon

Department of Economics, Michigan State College

There seems to be no evidence that tobacco taxation is consciously used for purposes of discrimination against out-of-state industries or business enterprise. The protection of home industry, the open or disguised aim of so much of our tax legislation, is not served by tobacco taxation but, rather, it is used for the simple and unsubtle reason that it brings in the money. The purpose of this discussion, then, is to consider a tax that operates as an interstate trade barrier because of the variation in rates from state to state, the non-uniformity of administration, and the cumulative effects of the burden upon interstate distributors.

Variations in Tax Rates

State taxation of tobacco products is about twenty years old and 26 states, widely scattered over the nation, now levy a tax upon one or more forms of tobacco. State legislators and tax administrators are thoroughly aware of the variety of tobacco products and in all of the 26 states agree on their matchless susceptibility to taxation. Agreement ends here, however. Fifteen states levy a cigarette tax of two cents per package; eight prefer three cents; one, Mississippi, levies four cents; and Arkansas and Louisiana col-

lect five cents. These rates are per package of 20 cigarettes which do not exceed three inches in length nor three pounds in weight per thousand. Larger cigarettes carry higher rates, and there are special rates for special packs. Ken-

TABLE 1

TOBACCO TAX RATES AS OF SEPTEMBER 3, 1940

	Cigarettes		Cigars		Smoking Package	Chewing Package	Revenue (1939) (In Thousands)	Vendor's License		
	Pkg.	1000	Each	1000				Wholesale	Retail	Base
Ala.	3¢[a]	$1.50	.3¢[a]	$ 3.00	3¢[a]	1¢[b]	$ 3,136	$100	$2/15	Population
Ariz.	2[a]	1.00	1/3[a]	3.33	2[b]	2[a]	617	5	1	
Ark.	5[a]	2.50	[c]	[c]	[c]	[c]	1,495	25	5/10	Sales
Conn.	2[a]	1.00	[c]	[c]	[c]	[c]	2,572	25	1	
Ga.	3[a]	1.50	.2[a]	2.00	[c]	[c]	2,502	[c]	[c]	
Iowa	2[a]	1.00	[c]	[c]	[c]	[c]	1,786	50/100	50/100	Population
Kan.	2[a]	1.00	[c]	[c]	[c]	[c]	1,130	12	5	
Ky.	2[b]	1.00	[c]	[c]	[c]	[c]	1,447	50	10	
La.	5[a]	2.50	.2[a]	2.00	4[b]	[c]	4,262	5	5	
Mass.	2[a]	1.00	[c]	[c]	[c]	[c]	[d]	25	1	
Miss.	4[a]	2.00	1[b]	10.00	3[b]	[c]	2,392	50/100	5/10	Population
N. H.	2[b]	1.00	¾[b]	7.50	2[b]	1½[b]	[d]	25	1	
N. Y.	2[a]	1.00	[c]	[c]	[c]	[c]	[d]	[e]	[e]	
N. D.	3[a]	1.50	[c]	[c]	[c]	[c]	499	5	5	
Ohio	2[a]	1.00	[c]	[c]	[c]	[c]	7,049	100	25	
Okla.	3[a]	1.50	[c]	[c]	[c]	[c]	2,153	25	10	
Pa.	2[a]	1.00	[c]	[c]	[c]	[c]	11,159	1	1	
R. I.	2[a]	1.00	½[b]	5.00	1½[b]	1[b]	173	25	1	
S. C.	3[b]	1.50	1[a]	10.00	3[b]	1[a]	2,369	[e]	[e]	
S. D.	3[a]	1.50	[c]	[c]	[c]	[c]	621	20	5/20	Population
Tenn.	3[a]	1.50	.2[a]	2.00	¾[b]	½[b]	2,528	5	2	
Texas	3[a]	1.50	[c]	[c]	[c]	[c]	7,109	15	5	
Utah	2[a]	1.00	[c]	[c]	[c]	[c]	324	10	10	
Vt.	2[a]	1.00	[c]	[c]	[c]	[c]	354	25	1	
Wash.	2[a]	1.00	[c]	[c]	[c]	[c]	1,085	1	1	
Wis.	2[a]	1.00	[c]	[c]	[c]	[c]	[d]			
U. S.	6½[a]	3.25[a]	.75	13.80	.18 lb.[a]	.18 lb.[a]	579,784			

Sources: Tobacco Merchants Association of United States, Federation of Tax Administrators, and *Tax Yields: 1939.*

Note: Cigarette rates based on package of 20, three inches long or less, and selling at 15¢. Cigar rates based on 5¢ cigar. Smoking tobacco rates based on 2 ounce package selling for 15¢. Chewing tobacco rates based on 2 ounce package selling for 10¢.

[a] According to weight or quantity.
[b] According to retail selling price.
[c] None.
[d] Effective 1939.
[e] No fee.

tucky and South Carolina levy their tax according to the retail selling price, while New Hampshire collects a flat 15 per cent of the selling price of all tobacco products.

Four states tax cigars. The rates on a five-cent cigar, good or bad, range from one-fifth of a cent in Georgia, Louisiana, and Tennessee to one cent in Mississippi and South Carolina. Cigar taxes vary with the retail selling price and the weight per thousand. Little cigars, cigarette size, have special rates in the seven southern states taxing them.

Eight states tax smoking tobacco. On a typical two-ounce tin, selling for fifteen cents, the rates run from three-fourths of a cent in Tennessee to four cents in Louisiana. The tax is determined by reference to the weight in some states and to the retail selling price in others.

Six states tax the usual two-ounce package of chewing tobacco, selling at ten cents, from one-half cent in Tennessee to two cents in Arizona. Tennessee exempts the rugged consumer who grows, makes, and uses his own twist tobacco.

Completing this picture, four states tax snuff and five levy an excise on cigarette papers and tubes. The rates vary, of course. It should be mentioned, also, that Arkansas makes provision for a different tax rate in border-line cities where the tax in an adjoining city outside the state border is different from its own rates.

Licensing Variations

In addition to levying a tax, the states have divergent policies with respect to licenses for tobacco vendors. Georgia requires no license from tobacco taxpayers; New York and South Carolina exact no fee for the license; and Arkansas, while charging a fee, makes the license valid until revoked. The other 22 states variously recognize importers,

distributors, wholesalers, jobbers, dealers, retailers, salesmen, and vending machines for licensing purposes. Taking retailers as the middlemen enjoying the greatest unanimity of definition in these laws, their licenses vary in cost from $1.00 in some eight states to $25.00 in Ohio. In Ohio, and in some other states, this fee is required for each place of business operated by the retailer. There are variations in most of the licensing states according to the size of the town in which the licensee is located or according to his annual volume of sales. A few states levy a flat license fee, regardless of the position of the licensee in the marketing channel. Alabama, apparently, requires the wholesaler to pay a tax not only to the state but also to each county in which he does business.

Administrative Variations

The collection, reporting, and remittance of tobacco taxes are subject to the same lack of uniformity. Some states, for instance, require monthly reports from dealers, some require no reports, while others require reports only when requested by the tax collection agency. Not all of the states have authorized the use of metering machines to register tax stamp use; there is no common policy with respect to discounts on tax stamp purchases; and, for that matter, not all states use tax stamps as the evidence of tax payment. The unstandardized gathering and reporting of tobacco tax information make it extremely difficult, if not impossible, to secure and compare the facts period by period, or state by state. Neither is it easy to measure consumption and evasion nor to estimate total revenue. The discrepancies are so considerable that the official figures reported by the states do not agree with those published by the Bureau of the Census.

It is not directly pertinent to this discussion, but in order to complete the description of the tobacco tax structure, it should be pointed out that the federal government has its own set of tobacco taxes. These include six and one-half cents on each package of standard size cigarettes, 75 cents to $13.80 per thousand on cigars, according to weight and retail price, and 18 cents per pound on chewing and smoking tobacco. At least eight cities, including New York, Denver, and St. Louis, have levied taxes on cigarettes.

Results of Present Tobacco Taxation

Repeating an earlier statement, tobacco taxes bring in the money. The federal government collected more than six hundred million dollars from this source in the last fiscal year, the states received something over sixty million dollars, and New York City reported an income of more than eight million dollars from its cigarette tax in the year ending June 30, 1939. In the face of these facts, it is extremely unlikely that the various tax jurisdictions will heed the pleas of the tobacco industry and the tax experts for repeal or downward revision of the rates. There is no doubt but that the industry bears an unusually heavy tax burden. Nevertheless, experience proves that having once found a good revenue producer, the tax authority will give more weight to productiveness than to the evidence of discrimination or theoretical inequity. The more practicable goal, then, from the point of view of both tax purists and opponents of interstate trade barriers, is uniformity in tax application.

In the consideration of some of the results of present tobacco taxation in creating trade barriers, cigarette taxes will be used as the basis of discussion since they furnish about 85 per cent of all tobacco tax revenues.

Reduction of Consumption

The variation in state tobacco tax rates produces inequality in the opportunity for consumption. Whereas the resident of non-tobacco taxing states uses 1,563 cigarettes per year, the citizen of those taxing the product buys but 956. The greatest difference in ability to buy may be illustrated by a comparison of prices between the states of Arkansas and Michigan. Arkansas has a state tax of 5 cents per package. This means that to the manufacturer's price of 5 1/40 cents is added 6½ cents for the federal tax and 5 cents for the state, or a total price, exclusive of middlemen's margins, of slightly over 16½ cents per package, or $1.65¼ per carton. Cigarettes can be bought at retail in Michigan for $1.18 per carton. The demand for cigarettes is still elastic enough that a 50 cent price differential will affect consumption. From another point of view, the pack-a-day smoker in Arkansas pays an annual total tax of $41.97, while his neighbor in Missouri pays $23.72.

Obviously, whenever the consumer reduces his purchases, the dealer loses volume. Wholesale establishments in the taxing states feel this keenly enough, but the most conspicuous sufferer is the retailer in a taxing state doing business near the border between his state and one levying a lower rate or none at all. The importation of cigarettes from tax-free or lower tax states by border-line commuters and motorists diverts a significant volume of trade from the taxing state and has undoubtedly forced many firms out of the cigarette business and deprived the taxing state of revenue. It has been estimated that the shrinkage in revenue amounts to approximately one-fifth of the total state tobacco tax collection. Texas claims to lose around $750,000 and Iowa $1,000,000 annually because of this practice.

Evasion

Other evasion devices furnish evidence of the barrier effects from state tobacco tax variations. Cigarettes are shipped into taxing states by parcel post, express, and freight. Dealers in tax-free or low taxing states have sent salesmen into the high tax states to solicit orders for future delivery. This activity comes under the legal definition of canvassing and is immune from state taxation as interstate commerce. So far as sales to domestic dealers are concerned, such a practice can be checked by making it illegal for retailers to have untaxed cigarettes in their possession. The taxing states now usually provide that tax stamps must be affixed before sale and a 24-hour limit is commonly set on the period during which the cigarettes may rest untaxed after receipt.

"Bootleg" sales direct to consumers, however, are more difficult to stop. The evader must be apprehended immediately upon the delivery to him or, in other words, upon the termination of interstate commerce. He cannot be caught before delivery, nor can delivery be prevented without interference with interstate commerce, and it is impracticable to detect tax evasion after delivery has been completed. This means that full enforcement requires constant surveillance over post office box and truck deliveries, incoming express packages, and the pick-up from inbound freight houses. An unusual evasion device is reported from Texarkana. The post office, there, straddles the line between Texas and Arkansas, and Texas has a cigarette tax two cents a package lower than that of Arkansas. It seems that cigarette shipments coming in the front door from Texas may leave by the back door into Arkansas without having left the interstate commerce protection of the federal building and without paying the higher tax. State tax administrators have vainly sought the assistance of the Post Office

Department in protecting the taxing states from evasion by parcel post shipments. A bill to require such cooperation has several times failed of enactment because of the opposition of the Post Office Department itself and of the Mail Order Association. Counterfeit tax stamps, bootlegging of untaxed cigarettes, spying on parcel post receivers, confiscation, litigation, and general border friction are the accompaniments of variations in state tobacco taxation.

Discrimination Among Distributors

In addition to the adverse and unequal effect upon consumers and the enforcement chaos brought on by variations in tobacco tax rates, the distributor of tobacco products suffers discrimination. The lack of standardized license fees and regulations makes for greater operating expense in some states than in others. Non-uniform discounts on tax stamps, different methods of collection, the variable expense of stamp application, and similar matters affect the efficiency of mass distribution. Mass production in the tobacco industry, as in so many others, has so increased productivity that mass distribution has become an essential complement. The latter, in turn, requires a broad market, a far-flung selling organization, and the assistance of an elaborate structure of functional middlemen. The marketing task is best performed when there are no artificial barriers to trade between the states. Technical changes and improvements in marketing facilities may reduce the physical obstacles to optimum distribution, but the imposition of legislative barriers so increases the cost of selling that profitable trading areas become limited. Such a reduction in distributive effectiveness brings a decline in sales volume and, ultimately, curtails the savings possible from mass production.

It is not at all unlikely that the national marketer, under increasing divergence in the taxation of his product, may

find it advisable to reduce the scale of his operations and of his advertising. For instance, national periodical, radio, and outdoor advertising would tend to be supplanted by newspapers, spot broadcasts, and point-of-sale media in the remaining tax-free or uniformly taxing states. As distribution becomes unprofitable in certain states or cities, the problems of market evaluation, territorial division, sales budgets, quotas, price policy, and general marketing strategy will rise to new heights of complexity. The cost of legal compliance in extra accounting, collection detail, and remittance procedure is already excessive, and it is apparent that wider non-uniformity will increase this burden.

The manufacturer of cigarettes made to sell for 10 cents per package of 20 feels the unequal tax burden with particular directness. Since so many of the states levy the tax on the package regardless of the selling price, the 10-cent brands bear the same tax as that borne by the 15-cent brands. Only in the three states levying the tax according to the retail selling price is there any equity in the application. In South Carolina, for example, the 10-cent brand bears a tax of two cents as compared with the three cent tax on those selling for 15 cents.

Pricing policy is complicated, also, in the case of the manufacturer of higher-priced cigarettes, who tries to keep the retail price of his product down by the absorption of the various state taxes. It is apparent that such a policy will preserve his position in competition with other brands only at a significantly greater burden in some states than in others. If this policy is abandoned, his retail price would get so far above the customary price of 15 cents that volume would be drastically curtailed. Maintenance of tax absorption to keep the price within close range of competition is accomplished at the sacrifice of profits. Variable rates are trade barriers, indeed, in this instance.

The existing variations in the rates, tax base, licensing, reporting, collection methods, and enforcement policy in tobacco taxation, then, do present differences in the conditions and opportunities for doing business in the various states. This results in producing trade barriers between the states and works a hardship upon producers, distributors, and consumers. Although a case may be made, there is no quarrel here with state tobacco taxation as such. The trade barrier effect is due, rather, to the existing lack of uniformity.

Removal of Barrier Effect

Opposition to state tobacco taxation has been mainly upon the grounds of its excessive nature and the fact of double taxation through the levying of both federal and state taxes on the same product. The removal of the barrier effect of state tobacco taxation can be accomplished either by the removal of the tax or by the standardization of state laws and their uniform adoption by all the states. Neither solution is an easy one, but the latter has more likelihood of eventual success. A campaign for the repeal of state tobacco taxes would probably be fruitless, since they have been found to be so productive of revenue even with the existence of rather large-scale evasion. The growing recognition by the states themselves, however, of the the difficulties and expense involved in enforcement under non-uniform conditions may bring action through the Federation of Tax Administrators for more interstate cooperation. Uniform state laws or interstate compacts can be used for this purpose, and both have a precedent of satisfactory employment. The tobacco manufacturers and the Tobacco Merchants Association should work along this line, and the various public and private agencies interested in the reduction of interstate trade barriers should furnish their support.

CHAPTER XII

TAX BARRIERS TO TRADE WITH RESPECT TO ALCOHOLIC BEVERAGES

THOMAS S. GREEN, JR.

Division of Defense Housing Coordination

IN MY personal trafficking and commerce in alcoholic beverages (alcoholically speaking, I am of the past prohibition era) I have never been obstructed by a barrier of any sort. I state this regretfully, for had I been obstructed, there might exist an obvious justification for my discussing this subject. My knowledge is purely academic in nature, gleaned from perusal of statute books, a smattering of history, economics, and politics, and discussions with those who are daily coping with the restraining effects of trade barriers. Although this approach may instill a degree of objectivity, I bow to the greater familiarity of those present who are associated with the alcoholic beverage industries or liquor control commissions.

LEGAL SANCTITY OF LIQUOR TRADE BARRIERS

Liquor trade barriers are not the common garden variety of trade barriers. They have distinguishing features. In the first place, they are endowed with legal sanctity which gives the states license to establish them with little restriction. No other trade barriers are so favored. Secondly, their political and social roots are founded in the prohibition movement, which waved valiantly the flag of states' rights. Other trade barriers are primarily economic in origin. The

only elements of comparability, in fact, are the economic motivations behind these trade barriers and the character of their manifestations.

Congress, early in 1933, proposed the substitution of the Twenty-first Amendment for the Eighteenth by providing in Section 2 that "the transportation or importation in any state, territory, or possession of the United States for use or delivery therein of intoxicating liquor, in violation of the laws thereof, is hereby prohibited." The states soon recorded their approval.

"The purpose of Section 2," stated Senator Blaine, sponsor of the Amendment, "is to restore to the states by constitutional amendment absolute control in effect over interstate commerce affecting intoxicating liquors which enter the confines of the states. The states under Section 2 may enact certain laws on intoxicating liquors and Section 2 at once gives such laws effect."

Unwittingly or not, the Supreme Court Justices have echoed in their decisions on the Twenty-first Amendment the substance of the Senator's remarks. Their echoes may well have sounded louder and more pervasive reverberations than the Senator either intended or anticipated. Briefly, in a series of cases, the Court has asserted that, once alcoholic beverages enter the state of destination, state regulations supersede federal laws with which they may come in conflict. Supposed violations of the commerce clause, the equal protection clause, and the due process clause of the Fourteenth Amendment have been upheld on the grounds that the Twenty-first Amendment takes precedence over other provisions of the Constitution. Federal regulations naturally remain unimpaired while the liquor is in transit across a state for delivery elsewhere, or when there is no conflict between state and federal regulations. And there is doubt

that the Amendment sanctions discriminatory liquor control laws which have only intrastate application.

The effects on interstate commerce have been far-reaching. The states now can, and do, extend preferential treatment to locally produced alcoholic beverages. They can, and do, favor alcoholic beverages from one state as against another. And they can, and do, punish each other for establishing these discriminations by engaging in retaliatory practices against each other.

Liquor trade barriers have then been given the stamp of legal approval. They are unique among trade barriers in this regard. This delegation of power to the states, though written into the Constitution for the first time, had made its appearance previously. In 1913, under the Webb-Kenyon Act, the substance of the present Amendment was provided for by statute. The history behind this development is to be found in the increasing pressure exerted on Congress by the prohibitionists for complete state control at a time when the theory of states' rights was flourishing. Congress yielded to their insistence and, in a series of acts, gradually limited the power of the federal government. The Supreme Court followed reluctantly, terming unconstitutional a number of laws on the grounds that they disregarded federal responsibility to regulate interstate commerce. But finally the intent of Congress became so evident that the Court gave sanction, first to the Webb-Kenyon Act, and more recently, to the Twenty-first Amendment.

What is most significant, particularly in analyzing the over-all trade barrier problem, is that liquor barriers were little known, if known at all, in the pre-prohibition days. The states, by and large, regulated imports "to the same extent and in the same manner" as they did their domestic

products, without indulging in discriminations and retaliations. It has only been with the advent of the depression, and the recourse to economic sectionalism, that the states have taken advantage of their power and used it to economic rather than social and moral ends.

There is only a technical distinction between liquor trade barriers and trade barriers affecting other products as manifested today. Most trade barriers made their appearance at about the same time. But whereas other local products are protected by indirection, i. e., inspections, quarantines, labelling requirements, and various circuitous excise and license fees, liquors are given preferential treatment through direct state taxation. No circumvention is engaged in, for interstate commerce can be obstructed at will.

Definition of Interstate Trade Barriers

Before examining these liquor trade barriers, it might be well to set forth a definition as a stepping stone. Interstate trade barriers, good or bad, justified or unjustified, exist whenever competitive markets are affected by the presence of state boundaries in such a way as to favor in-state producers and distributors at the expense of importers from other states, or to favor some importers at the expense of others.

Where such a definition is applied to the regulation of alcoholic beverages, we find trade barriers existing when "higher excise taxes (are) imposed on products manufactured or packaged outside the state than are imposed on those manufactured or packaged within the state; higher license or other fees (are) imposed on out-of-state manufacturers and wholesalers than are imposed for a like privilege on local manufacturers or wholesalers; and other ship-

ping or merchandising restrictions (are) directed to the same end."

Such trade barriers, then, are established through the medium of license fee differentials, excise tax differentials, and merchandising restrictions which tend to discriminate against out-of-state alcoholic beverages and in favor of domestic ones.

Merchandising Restrictions

Since merchandising restrictions are of less immediate interest in discussion of tax barriers, and indeed are less widespread, it might be well to dispose of them first. As stated previously, there is some question as to whether they can be supported under the Twenty-first Amendment.

Eight states require from one to three years' residence as a condition for obtaining a manufacturer's or wholesaler's license. Iowa and Washington permit local wineries to sell directly to licensed retail outlets, while imported wines must be sold to the state monopoly which charges a percentage tax. Utah and Maine compel the state liquor stores to display native-grown products in preference to out-of-state ones when price and quality are equal. In five barley-growing states beer must be manufactured from not less than 66 2/3 per cent barley malt. Other requirements are that brand names be registered with the state authorities and a fee paid, while one state, Ohio, where all blends of wine must contain at least 51 per cent native wine, prohibits the importation of wine in tank cars except when it is to be blended with native wine, although the state permits exportation by tank cars without restriction.

Tax Barriers Affecting Alcoholic Beverages

Turning to tax barriers affecting alcoholic beverages, we find that they are familiar and common provisions. Forty

states are now party to such discriminations. Many have adopted more than one type of tax to widen the scope of protection and make more stringent their control.

Among license fee differentials, the most common, and one which has been adopted by 21 states, is the requirement that out-of-state producers who have no place of business within the state and who wish to sell to licensed wholesalers or state monopolies must obtain a license or a certificate authorizing them to do business within the state. Such measures constitute trade barriers, inasmuch as they impose on importing producers a second license fee (one having been imposed upon them in their own state of residence) without subjecting local manufacturers to similar double license requirements. The wholesale licenses vary from \$50 to \$1,000, and the so-called certificates of approval range from the mere formality of registration, requiring no fee, up to a cost of \$750. At what license fee rate these measures begin to restrict importations is difficult to determine. It is possible that high fees cause no hardships to large producers who can absorb the cost in their general overhead without raising prices. On the other hand, even a low fee may completely deter a small producer.

Probably second in importance are license fee differentials which tend to subsidize farmers by placing a premium on the use of native agricultural products. More than a dozen states have enacted such measures. This subsidy is usually implemented by assessing higher fees on manufacturers who use imported raw materials than on those who use exclusively native-grown products. It is frequently intended to protect farmers who grow a small quantity of grapes and who ferment the wine on their own premises, although it may also serve as a subsidy to the state-wide industry or to production in a localized area of the state. One state, for

example, levies a license fee differential on a sliding scale, the differential amounting to anywhere from \$100 to \$3,000, depending on the proportion of native and imported raw materials. In other states, a higher fee is levied if any imported products are used, sample differentials being \$20, \$225, and \$900.

A third license fee differential is enforced in 10 states by imposing on wholesalers who distribute alcoholic beverages produced out of the state a higher rate than on those who handle exclusively products manufactured domestically. The margin of difference is as high as \$200 in one instance and \$650 in another, where wholesalers of domestic products are assessed \$50, as against \$700 for merchandising imported beverages.

Turning from license fees to excise taxes, we find a discrimination less widely adopted, but more vicious in character. Eight states assess a higher gallonage tax on imported alcoholic beverages than on similar ones produced within the state. It is obvious that the differential, particularly if large, places the imported product at a marketing disadvantage. One state has a five-cent differential, perhaps not excessively burdensome, but others reach as high as 46 cents. And there is one instance in which a state monopoly imposes a 10 per cent retail sales tax on imported wines and 10-cent gallonage tax on native wines. The sales tax probably averages twice the gallonage tax.

Causes of Liquor Trade Barriers

It is a simple matter to condemn trade barriers. At the mention of the term most people will nod their heads knowingly, as though to say: "Very undesirable, very dangerous." Because of this public attitude, there may be tendencies to earmark as trade barriers certain regulations which, though

justifiable measures of state control, are unwanted and hence attacked. For this reason it is important that a formula or technique be adopted, which, through analysis of essential factual data, can demonstrate to those responsible for establishment of a regulation whether or not it creates an actual interstate discrimination. In the present absence of such a formula, I have examined the causes of liquor trade barriers and have analyzed their over-all effects.

Although general economic adversity can be assigned as a causal factor for the establishment of the trade barriers, the motives behind those affecting wine, beer, and distilled spirits can be more clearly defined and distinguished. Likewise, although their effects cannot always be accurately determined, some examples can be cited of the economic restrictions they have created.

Protection of local grape-growers and their wineries can be selected as the main reason for adopting wine discriminations, although in a few cases they may have been promulgated primarily to increase tax collections. The arguments supporting this contention run as follows: Only a limited number of states produce enough wine from locally cultivated vineyards to export in large quantities. Among them are California, which out-produces all her sister states combined, followed, in tonnage yields, by New York, Ohio, Washington, Michigan, New Jersey, Arkansas, North Carolina, Oregon, Illinois, Minnesota, and Georgia. Yet 22 of the remaining states also produce wine. In most of these the grapes are grown by small farmers who allot a part of their acreage to vines, with the intention of fermenting the grapes on their own premises for sale in a nearby market. Since wine fermentation must take place near the site of the vineyards, because grapes are both too bulky and too perishable to be transported any great distances, it is evident that

most wine production is concentrated in a few localities. This factor, along with the disparity in processing costs between small and large wineries, is the important source of wine trade-barrier legislation. The small farmers and wineries fight to preserve their local markets from the competition of importers from large producing areas.

The situation is somewhat different with respect to beer. In the first place, some of the necessary agricultural products are grown in only a few areas. Such is the case with hops and rice; barley is malted mainly in three states; and corn, the fourth ingredient, is grown in all states, though obtained by the brewing industry largely from the midwest farm belt. The problem, therefore, is not one of intensive competition among farmers. Where the competition is to be found is among the brewers. During 1937-38, 615 breweries were listed, scattered among 40 states. Half a dozen states had but one brewery, while the figures ran as high as 84 in Wisconsin and 103 in Pennsylvania. Thirteen of these states produced more than a million barrels each a year, and accounted for 87½ per cent of the national total. Thus we find that although both farmers and brewers are interested in maintaining unrestricted interstate shipment of agricultural products, the marketing of the beer itself is usually subject to stiff competition between local breweries as well as between the national and local brewers. Individual brewers want protection in their already overcrowded markets and seek the support of the legislature in this endeavor. In 24 beer-producing states, one or more local brewers' associations have been organized, whereas only three national or regional associations exist. This further accentuates the chaotic condition of the brewing industry and tends to place emphasis on its state, rather than its national, aspects.

Trade barriers affecting distilled spirits cannot be at-

tributed to clearly defined causes. Only 28 states produce at all, and 98 per cent of the total gallonage is accredited to nine states. Of this group, two have not passed any discriminatory measures, and the remainder have insignificant ones. As for the raw materials, there seems to be little geographical relation to the sites of distillation. The only conclusions reached are that distilled spirits trade barriers are offshoots of the trade-barrier movement and find their roots in legislation protecting beer and wine, rather than in economic factors of their own.

Effects of Liquor Trade Barriers

Motivations are important to analyze in themselves, but they only become economically significant if the ultimate objective, that of economic protection, is accomplished. The over-all effects of trade barriers on our economic life cannot accurately be determined. But specific instances in which they have created economic hardships can be isolated and analyzed. Most of the wine produced in this country comes from California. In 1938, figures were nearly 55,000,000 gallons for California and 7,500,000 gallons for the other 47 states. With the exception of California, the individual states consumed most of their own wine. California, in that year, however, exported 39,000,000 gallons. Any wine trade barriers, therefore, were probably first directed at California's products. Their effect on this state has been decidedly noticeable throughout the country. Between 1937 and 1938, the nation-wide consumption of California wine dropped more than 3,000,000 gallons, while that of the other states increased by 2,700,000 gallons.

Several of the large grape-growing states have enacted stringent discriminations by excise tax differentials, as has

been previously pointed out. The effects have been significant.

In 1938, Michigan consumed less than 180,000 gallons of non-native wine, primarily as a result of a 46-cent tax differential. On the other hand, Ohio, where trade barriers are far less stringent, consumed, with only a slightly larger population, 2,400,000 gallons of non-native wine. Washington has consumed increasingly less imported wine since 1935, in which year it enacted a trade-barrier law, while consumption of native wines between 1935 and 1938 has risen from 62,000 gallons to 655,000. A similar development is found in Arkansas. After the gallonage tax on out-of-state wine was increased from 10 cents to 50 cents, the tax on local wine remaining constant at five cents, consumption of non-native wine dropped 44 per cent, from 323,000 gallons in 1937 to 181,000 gallons in 1938, while that of native wines increased almost 25 per cent, from 135,000 to 168,000 gallons. Most significant, when examining the effects nationally of these wine trade barriers, is that per capita consumption in the large-producing, trade-barrier states has shrunk, whereas the consumption in the other large grape-growing states without trade barriers has increased.

In contrast, discriminating states which do not rank among the large producers, show, with few exceptions, increased per capita consumption figures from 1934 to 1938. A number of explanations are at hand. The trade barriers may be unimportant or ineffectively enforced. A likely explanation, however, is that local production in these states did not fulfill market demands, and out-of-state wines were sold despite the barriers and resulting higher prices. Supporting this argument of an unsaturated market are the per capita consumption figures of Indiana, a small producer—0.084 gallons—compared with the figures of New York and Cali-

fornia, the two largest producers, which are, respectively, 0.758 gallons and 3.267 gallons.

With regard to beer, less convincing factual data on the effect of trade barriers are available. It is reported that about 85 per cent of the breweries wish to ship in interstate commerce. How many are deterred by trade barriers is difficult to determine, though some estimates have been made.

Vermont's $750 certificate of approval on out-of-state breweries has perhaps had the most far-reaching effects. A survey shows that, although 74 breweries would like to ship into this state, only 34 actually do. In a large proportion of these cases it is the certificate which has deterred them. In New Hampshire, where the fee is $500, only 44 out of 58 interested brewers market their beer in the local markets. Thirty-three out of 62 ship into Maine, where the certificate cost is $100. And in Colorado, which requires out-of-state brewers to obtain a wholesaler's license at $100 for 3.2 beer and at $500 for beer of heavier alcoholic content, reports show that only 18 breweries import, although 30 shipped into this state before enactment of the trade-barrier law.

Another type of trade barrier has prevented many brewers from shipping into Massachusetts, New York, and New Jersey. These states impose licenses on solicitors from out-of-state manufacturers, at $300, $500, and $750 respectively. Forty-one brewers have obtained such licenses in New Jersey, but another 31 would otherwise solicit. For New York the figures are 28 and 47, and for Massachusetts, 10 and 57. Naturally, breweries can fill orders received out of the state, thus avoiding the restrictions, but breweries must convince consumers of the quality of their product first, and this is difficult to do without actually placing it in the local market.

The distilled spirits industry has undoubtedly been harmed by trade barriers, but it is difficult to determine the extent. Since production is concentrated in nine states, competition in any one market is more intense between the regional or national distributors than between local state distillers on the one hand and importers on the other. Hence, any trade barriers probably fail to protect local producers to any great extent.

Possible Modes of Attack

Trade barriers are significant examples of defects in our economic system, for they tend to restrict production and distribution, to raise prices, and to create innumerable economic disturbances and unfavorable social and political repercussions. The repeal of trade barriers is greatly to be desired under normal conditions. At the present time, when we are thinking in terms of national defense and of the mobilization of our economic forces to their fullest strength in what is a race against time, their repeal is of the utmost importance. This economic mobilization means the total coordination and integration of our economic machinery, but of equal importance it calls for the removal of all those defects in our economic system which obstruct its normal processes. Accumulation and interrelation of these defects have caused, and will continue to cause, irreparable delay.

As far as liquor barriers are concerned, the vital focus of attack would be the Twenty-first Amendment. This is not the most vulnerable, however, for it seems unlikely that the Amendment will be repealed in the near future. Upon the states, therefore, and solely with them, rests the responsibility to rectify this situation. Trade barriers can be repealed outright, interstate compacts can be entered into, reciprocal agreements can be negotiated, or administrative

rulings can be handed down. The problem can be and has been solved in many ways. These economic barriers which breed interstate disunity must be removed. Otherwise, the states will be largely handicapped in their efforts to muster all their legislative and administrative machinery to a single and inclusive objective—national unity.

CHAPTER XIII

PROBLEM OF ELIMINATING LIQUOR TRADE BARRIERS

Ralph E. Curtiss

Counsel for Repeal Associates, Inc.

The historical background of the constant struggle to erect trade barriers which will benefit the few at the expense of the many, and its enormous influence in shaping our own governmental system are too well known to need comment here. It is sufficient to say that our Constitution provided the means for keeping open the channels of trade between the several states by giving to the Federal Congress undivided power to regulate interstate commerce; and that for nearly a century and a half no trade barrier was set up except as a necessary and proper exercise of the police powers of the state concerned, or by subterfuge where use was made of a permitted power to accomplish a purpose not intended to come under that grant of power and not otherwise legally attainable. Prior to the passage of the Twenty-first Amendment, no state laws could have been enacted for the sole and admitted purpose of discriminating against the products of another state.

Senator Blaine, who sponsored Section 2 of the Twenty-first Amendment said: "The purpose of Section 2 is to restore to the states by constitutional amendment absolute control in effect over interstate commerce affecting intoxicating liquors which enter the confines of the states. The states under Section 2 may enact certain laws on intoxicat-

ing liquors, and Section 2 at once gives such laws effect." It will be noticed that he said "restore to the states . . . control," and that "The states may enact certain laws," etc.

Since the power to regulate commerce among the several states was vested in Congress and, under the Constitution, had never been vested in the states, it is reasonable to conclude that the framers of Section 2 did not have in mind an attempt to bestow upon the states powers which had never been theirs, but only to restore such powers as had been taken from them by the Eighteenth Amendment. Judicial interpretation, however, has clearly established the doctrine that Section 2, as written, gives to any state—whether prohibition or non-prohibition—the right to exclude or restrict, as it sees fit, the commerce in liquors which originate outside its own borders.

Liquor, then, is the one commodity that is constitutionally subject to whatever type of discriminatory legislation a state legislature may enact, which in most cases takes the form of excise or license differentials. The fact that barriers *in general* are established by indirection sets a ceiling beyond which no legislation may go. In the case of alcoholic beverages alone, there is no restraining ceiling; the sky is the limit. It is apparent, therefore, that a distinct cleavage exists between trade barriers in general and those affecting alcoholic beverages.

This difference both simplifies and complicates the problem of eliminating liquor trade barriers. It simplifies because, first, liquor laws and regulations which are *in fact* discriminatory, are so recognized, and may be directly treated as such; and, second, the power to act rests undivided upon the respective states. It complicates because of the differences of opinion among state officials as to what constitutes discrimination and the fact that the states have

no right of appeal to the federal courts for definitions when the case relates to liquor barriers.

There are those who believe that alcoholic liquor is a commodity that cannot be too severely restricted, but, regardless of what may be believed about its consumption, the fact remains that its manufacture, distribution, and sale constitute a major industry. Public revenues from this commodity have exceeded five billion dollars since 1933, and hundreds of thousands of persons are either directly or indirectly employed by this industry. It is an important economic factor in this country. Thus, barriers that prevent a reasonably regulated flow of alcoholic beverages in interstate commerce affect the national economy to the same extent that other commodity barriers affect it.

At the present time we hear a good deal about national solidarity and cooperation. If this is to be accomplished, one of the best starting points is the abolition of trade barriers. At one time the friction between two adjoining states became so great, because of liquor trade barriers, that the officials of one state contemplated the revocation of a preexisting reciprocal agreement on motor truck licenses. The officials of another state contemplated refusing to buy motor vehicles for their state from manufacturers located in a state which discriminated against their beverages.

Long experience has shown that points of difference between states can be adjusted when the states themselves determine, by mutual agreement, to do so. For more than a hundred years agreements between the states have cleared away difficulties arising from conditions over which no single state might have complete control, but which were not properly under the jurisdiction of the federal government.

The marked progress toward state cooperation that has come in the past year or two in matters pertaining to liquor

control demonstrates the possibilities in this field. The strong and widespread trend toward discriminatory and retaliatory liquor laws has been decisively checked, and already, in some states, definite programs have been initiated for the purpose of cooperation on this and various other matters. This improvement in the liquor control situation is largely due to conferences—notably those sponsored by the Council of State Governments—where administrative and legislative officers from different states could discuss practical ways of helping one another.

As one means of furthering this program of interstate cooperation, it would seem highly desirable that "discrimination" be clearly defined and the definition accepted as soon as possible by all parties concerned, in order that the way may be cleared for continued and constructive consideration of the subject along the lines as have been pursued for the past two years.

The partial solution of the problem of liquor trade barriers accomplished in the past two years is only a starting point for complete eradication, but the movement has gone far enough to indicate further successes. By continuing this promising movement, the officials of the states can reduce much of the friction and confusion now resulting from alcoholic beverage trade barriers and make a worth-while contribution to national unity. In view of all the circumstances involved, it would seem not only desirable but necessary that the gains which have been and will be made, be consolidated, and the resulting benefits perpetuated by the adoption of formal compacts between the states as soon as practical.

PART FOUR

MARKETING TRADE BARRIERS

CHAPTER XIV

PROTECTIONISM AND CHAIN STORE TAXES

MAURICE W. LEE

School of Commerce, Utah State Agricultural College

THE discussion of chain store taxes as a part of a program dedicated to the analysis of trade-barrier legislation presupposes that such taxes belong in this category. I should like to raise the question as to whether chain store taxes do belong in the same category with liquor taxes, sales taxes, and vendor fees, as barriers to the interstate flow of goods.

BACKGROUND OF CHAIN STORE TAXATION

Although most of you are familiar with the general nature of these chain store taxes, I should like to talk for a moment or two about the background of this movement and summarize briefly the current status of these discriminatory levies.

When the legislators of Georgia, Maryland, and North Carolina enacted the first chain store taxing statutes in 1927, they were not greatly concerned about the problem of general welfare or public good. It was the well-being of an important part of their electorate which was of interest. The independent merchants and the middlemen who sold to them were making known their alarm over the strides made by multiple stores, and the legislators, concerned over the position of any vocal element in their constituency, were not slow to realize the political value of attacks upon the chain stores. Other motives, other types of justification for the

chain store taxes have, of course, appeared during the intervening years, but the movement obtained its initial momentum in the manner just indicated.

Although there are several variations from this pattern, the chain store taxes in effect today fall roughly into two classes. Most of the states impose graduating levies which attain their higher levels in accompaniment with the larger size of the chains as measured by the number of their units located within the taxing state. The rest establish similarly graduated rates but disregard the location of the stores, counting the total for the chain as the number of units it controls, whether located within the taxing state or elsewhere.

In the whole history of chain store taxation in this country there have been but three basic types of enactment.[1] When the United States Supreme Court upheld the Indiana statute[2] in *State Board of Tax Commissioners* v. *Jackson*,[3] it established the validity of those taxes noted above, which were based upon the number of stores within the taxing state. After this decision was given state followed state in emulation of the Indiana pattern.

In the meantime an abortive attempt was made by several of the state legislatures to enact measures establishing graduated levies, the rates of which rose with a larger sales volume. Here the total sales transacted within the state by a chain was taken as the standard rather than the number of stores. The United States Supreme Court wrote *finis* to such attempts in 1935 when it reviewed the Kentucky gross

[1] There have been several types other than the three which are noted here, but they were either short-lived or unimportant and do not appear to be basic types. For a detailed classification of chain store taxes, *see* Maurice W. Lee, *Anti-Chain Store Tax Legislation,* p. 11, where a ninefold tabulation is presented.

[2] *Laws of Indiana, 1929,* Ch. 207.

[3] 283 U. S. 527 (1931).

sales tax on chains[4] and held the act to be a violation of constitutionally guaranteed rights.[5]

These two cases, one from Indiana and one from Kentucky, settled the course of chain store taxation until 1937 when the Supreme Court again issued an important decision, this time involving the Louisiana statute[6] which imposed a graduated tax based on the total number of stores operated by the chain whether within or outside of that state. In its decision in this case the court said: "If the competitive advantages of a chain increased with the number of its component parts (in line with the Indiana decision) it is hard to see how these advantages cease at the state boundary."[7]

With these three rulings on the record, the course of chain store taxation up to the present time was established. One, the Kentucky decision, was negative and disallowed attempts to tax the chain in terms of their sales volume. The other two were permissive and allowed the states to impose graduated rates based, first, upon the total number of stores located within the state, the Indiana ruling, and, second, upon the total number of singly controlled stores, wherever located. There are a few variations from these two broad classes of currently permitted chain taxation, such as the Tennessee graduated levy based upon the total amount of floor space owned or leased by the chain within the state, but in general the 19 state laws now in effect are true to, or represent, variations from the two classes noted.[8]

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[4] *Laws of Kentucky, 1930,* Ch. 149.

[5] *Stewart Dry Goods Co.* v. *Lewis,* 55 S. Ct. 525 (1935).

[6] *Laws of Louisiana, 1935,* Ch. 51.

[7] *Great Atlantic and Pacific Tea Co.* v. *Alice Lee Grosjean,* 57 S. Ct. 722 (1937). Phrase in parenthesis by the writer.

[8] Nineteen laws, as of May 1, 1940. *See* Maurice W. Lee, "Recent Trends in Chain Store Tax Legislation," *Journal of Business,* July, 1940, pp. 258-60.

Taxation for Nonfiscal Purposes

The whole question of discriminatory chain store taxation involves the broader question of taxation for nonfiscal purposes and, although the subject of regulatory taxation has already been covered in these meetings, I should like to review the topic briefly in the light of what is to follow.

We may assume that the primary purpose for which the taxing power was granted was to provide the governments with revenue in amounts sufficient to meet their costs of operation. Thus, while some taxes are designed to produce only enough revenue to meet the costs of a specific program, as evidenced by certain of the business license fees, others such as the income, property, and sales taxes are designed to provide revenue ample to cover all their collection and administrative costs and still leave sufficient to meet other governmental expenditures. Both of these types belong to the class of revenue taxes created to cover the costs of regular government functions.

By contrast with the foregoing, there has been a tendency for taxes to be imposed for a quite different purpose than that just noted. Often a levy is introduced in order that government may effect a type of regulation which might be difficult to justify as an exercise of the police power, if a state were involved, or perhaps of the interstate commerce power in the case of the federal government. These governments have then turned to their revenue powers, using them as a guise for a specific regulatory program.

Although there is no question, of course, that revenue taxation, itself, has a social impact which often produces instances of discrimination, the fact remains that such levies are created for the primary purpose of producing income for the taxing body. Corporate income taxes are undoubt-

edly quite discriminatory insofar as their ultimate effect is concerned, but their principal *raison d'etre* is still the production of revenue. Such is not the case with the nonfiscal, regulatory taxes, of which chain store taxes are a more than satisfactory illustration. Their aim is regulation—discrimination—and the production of revenue is a secondary and often trivial matter.[9]

Protectionism and Chain Store Taxes

I should like now to give more detailed attention to this subject: "Protectionism and Chain Store Taxes," and perhaps to attempt an evaluation of the term "protectionism" as it relates to the specific issue of chain taxation.

The fundamental philosophy which lies behind the protectionist thought is negative, embracing an attempt to improve the position of a particular and rather limited group, not through the ordinary method of improving the operating efficiency of that group, but rather by means of handicaps placed upon competitors, in order that the sponsors of such a program may not be under such strong compulsion to greater efficiency. This is the basic philosophy of protective tariff advocates, of trade-barrier proponents, and of chain tax supporters.

Implicit, also, in the protectionist philosophy is the belief that so-called "hard times" are the product of an excessive supply rather than any decline in demand. The entrepreneur, whose position becomes difficult during such times,

[9] In an earlier study by the present author, *State Anti-Chain Tax Legislation,* p. 75, the results of an examination conducted in the case of the revenue yields from these taxes were given. The study sampled five representative states in the years 1932-36, and it was found that in no one of these states did the revenue from chain taxes produce as much as one-half of one per cent of the total tax revenue of the state. Chain store tax yields and percentages for the years 1936-1939 may be found in *Tax Yields: 1939,* pp. 40, 102.

looks for straw men who can be blamed for the unbalanced situation. Logically, in terms of his position, he finds that his keenest competitors are the guilty members of the economy. Ordinarily, the complaints of one such entrepreneur will be offset by countercomplaints of another, and no united group will emerge to attract legislative attention. When the situation becomes serious, however, it may be that attempts will be made to bar outside products from the domestic market, national or state, as the case may be. If this does materialize, tariff rates rise, and interstate trade barriers enter the statute books. It may be, however, that the pressure upon a fairly large group appears to come from a single or limited source, so that a crystallization of hostile sentiment develops sufficient magnitude to lead to the enactment of special-interest legislation discriminating between interests within the state or nation. This was the case with the chain store taxation movement.

During the early and middle 1920's, the small independent merchants and their middlemen awoke to the realization that the chain stores were rapidly attaining supremacy in a variety of fields. Although there had been chain stores within the country for many years previous to this period, they attained their greatest growth during the war and post-war eras, and the menace did not seem very great to most of the independent dealers until the middle of the twenties. Unable to make the adjustments required in the face of the multiple store competition, the independent dealers began to complain of unfair competitive advantages held by the chains, of their parasitic nature in the community, and of their lower tax burdens, with the results which we have already noted. Legislators in North Carolina, Georgia, and Maryland answered the appeal in 1927, and others followed during the next years. Whatever other arguments

may have been advanced later in support of chain taxation, it is clear that the initial impetus derived from the protectionist idea of penalizing low-cost operators.

The chain stores were looked upon as outsiders, dumping their products upon a domestic market to the demoralization of the established dealers. Inasmuch as the independent dealers were the vocal group during this period, they believed that the domestic market could be saved, if the surplus of retail outlets was removed, and that the chain stores represented the surplus.

It is now evident that the basic philosophy behind the chain store taxing movement was quite like that supporting the recognized protectionist movement—it was negative, offering advancement for a selected group through the channel of penalties meted out to their competitors.

Chain Taxes and Trade-Barrier Legislation

The next question to be considered is this: "Are the chain store taxes a part of the regular trade-barrier movement?" In order to find the answer to this question, it will be necessary to note first the characteristics of trade-barrier legislation.

The most important feature of such legislation and a thing common to the whole movement is this: It protects the products and enterprises of the legislating state from competition originating outside of the state. This is true of milk and dairy product laws, of motor vehicle restrictions, of livestock laws, of liquor legislation, and port-of-entry statutes. Whether chain store taxes accomplish this same thing seems questionable.

In the first place, chain taxes are not imposed upon entities outside of the state but are levied upon groups within the state. These laws, whether of the Indiana or Louisiana

type, fall directly upon stores within the geographical confines of the taxing entity. It might conceivably be argued that such laws, operating in only one or a few states, would have the effect of driving chains from those states into nontaxing regions and that the legislation would thus be not unlike other barrier enactments. However, since half of the states have had such laws at one time or another, the chains have generally decided to remain where they were, assuming for themselves that part of the taxes which they were unable to escape or shift to others. More than this, the chains have discovered that one of the best methods of minimizing the effects of the tax is to combine individual units into superstores, having a total business volume in excess of the combined sales of the formerly individual outlets. In more than a few states the result has been an increase, rather than a decrease, in chain share of total retail business. In either event the operation of the chain store taxing laws is such that the chains (except in the event of wholly confiscatory rates) would not be driven from the taxing state. By contrast we note that trade-barrier legislation does not depend for its effectiveness upon the absence of similar legislation in other states. Whether one or 48 states have such legislation, the effect is to conserve the state markets for internal enterprise.

There is another aspect of the chain taxes which suggests that they are different, in effect, from the regular trade-barrier laws. With the exception of the Louisiana law, the usual chain impost is, as has been indicated, of the Indiana type, with graduated rates based upon the total number of stores within the state. Thus a comparatively low rate is set for a single store, a somewhat higher levy for perhaps the next four, a still higher rate on the next five, and so on—but only the stores within the taxing state are counted.

Under such statutes a large national chain may pay an appreciably lower total tax to any given state than a smaller local chain will pay under the same law. If the larger chain, having several hundred stores, diffuses those stores widely throughout the country, leaving no unusually large number in any single region, it will pay smaller taxes in each state than will the much smaller local chain, having all of its stores within the state. The national chain, because of the advantages which its large size gives to it, may undersell its competitors, both local chain and independent, may have higher profits, and constitute a much more serious threat to local interests than the smaller chain, yet pay a lesser tax.

The chain levy, far from discriminating in favor of local interests, would appear to have moved against them in certain cases. It is evident that the larger chains have been less seriously wounded in many instances than the smaller ones and that the out-of-state national chains may, on occasion, have gained through the enactment of this legislation which by handicapping the local chains, has permitted these larger groups to move into positions of greater relative control. Such a result is scarcely consistent with the intentions of state trade-barrier legislation, and on this count, as well as those already noted, chain taxes do not fit the characteristics of barrier measures.

There is yet another way in which chain store taxation fails to conform to the pattern of interstate trade restrictions. Most of the state barrier laws are specifically designed, tailor-made, to fit directly the product or producer being discriminated against. Thus there are margarine laws, motor vehicle enactments, and agricultural product quarantines, all of which relate directly to, and discriminate specifically against, definite things. Chain store taxes do not do this. They are broad, sweeping measures, embracing

a whole class of interests, in a wide variety of fields, without regard to individual differences within the class, save on the basis of number of stores. Yet it has been shown on many occasions that there is almost no real relation between the number of stores and the volume of business, the amount of profit, or the degree to which independent merchants are losing their business to the chains. Here, then, is a third point of difference between chain taxes and state barrier enactments: The chain taxes are too broad to take account of real differences and frequently accomplish quite another purpose from that intended.

We may turn now to some points of similarity between these statutes and the regular trade-barrier measures. There is some evidence that the popularity of the chain taxing movement was not completely unrelated to the problems which the Great Depression posed for all entrepreneurs. During the depression there has arisen a great variety of proposals for restoring full employment. Some were positive, in the sense that they proposed to "do something for" someone. Others were negative, in that they proposed to "do something to" someone. In this class was the "Buy America" program of the early thirties, a proposal to supplement tariff restrictions upon imported goods with an internal boycott of such goods as slipped over the tariff walls. This was broadened when the "Buy in Your Own Neighborhood" campaign was inaugurated, principally as a mode of attack upon the chains. There developed an internationally discriminatory combination of tariff protection and "Buy America," which had its counterpart in the internally discriminatory combination of trade barriers and "local patronage."

In line with the foregoing, it appears that chain store taxes, although not a part of trade-barrier legislation, are

a supplement to it. Nor does this ignore the fact that chain store taxation was popular before trade-barrier legislation reached its maximum intensity. All were parts of the same philosophical movement, with chain taxation designed to augment the "local patronage" aspects of interstate discrimination. Viewed in this light, as a supplement to, rather than a part of, the trade-barrier movement, chain store taxation deserves to be considered along with the rest of the program.

The Future of Chain Taxation

With regard to the future of chain store taxation, there appear to be a few basic trends in evidence which permit some forecasting to be made.

Until 1937 there was little in the picture that offered a chance for optimism on the part of the chain; since that date the scene has changed. There are now fewer laws in operation than existed in that year, three having been invalidated by the courts, while one was allowed to expire without replacement.[10] Over this same span of years only two new statutes were enacted. With the birth rate for chain taxes falling below the death rate, there is some room for a belief that the high point has been already attained and that the future will lead to a further projection of this trend.

There is some value in speculating upon the causes for this about-face. The most evident explanation might be that so many of the states now have such measures that a

[10] These three cases involved laws of Pennsylvania, Minnesota and Kentucky.

American Stores Co. et al. v. *State,* 6 Atl. (2d) 826 (1939), Penn.
National Tea Co. et al. v. *State,* 286 N. W. 360 (1939), Minn.
Great Atlantic & Pacific Tea Co. v. *State,* 128 S. W. (2d) 581 (1939), Kentucky.

The statute which expired without the enactment of replacing legislation was the 1937 Wisconsin law.

natural decline is to be expected. There is something to this as an explanation for the declining birth rate, but it does not explain the rising mortality among these statutes and the rather evident effort by the courts to see grounds for the condemnation of these statutes, where only a few years ago the same courts were straining to find means for upholding them.

It may be no more than coincidental that the changing attitude has developed along with an increasing effort on the part of the chains to combat this discriminatory legislation through more intensive work before the courts and the general public. There is a very close correlation between intensive chain efforts to combat such legislation and their success in doing so. In fact, the correlation is so high that one further conclusion seems warranted. The method promising fullest success for the chains in their attempts to arouse judicial condemnation of the chain taxes lies, not in the preparation of imposing legalistic briefs to be presented to the courts, but rather in the presentation of briefs weighted heavily with economic analysis, with factual rather than legalistic content. If the chains do this, there is every ground for predicting a near-complete reversal of court decisions on the matter of discriminatory chain store taxation.

Evaluation of Chain Store Taxes

An evaluation of the merits and demerits of chain store taxation must proceed from the assumption that this is a program of regulation, not taxation. These taxes are therefore to be appraised by standards which would be used to judge a regulatory program, and not as one would measure the worth of an ordinary taxing statute created for the purpose of producing revenue.

One of the first requirements demanded of any regulatory program is that it should meet some need for regulation.

This is so obvious that it is often overlooked, yet, certainly, the enactment of regulatory legislation where none is needed is, if not harmful, at least, wasteful. Most of the justifiable criticism of the chain stores, most of the objectionable practices against which these taxes are popularly supposed to be directed have now been regulated by federal and state governments under the Miller-Tydings and Robinson-Patman Acts and their counterparts in the various states. Therefore, inasmuch as legislation more closely related to the objectionable features of chain operation is now in force, there can be no justification for chain taxation as a regulatory measure. This is particularly true since the taxes do practically nothing to discourage the taking of excessive quantity discounts or the use of unfair trade techniques and in fact may, by the pressure which they exert upon costs of chain operation, actually encourage utilization of such techniques. Thus another ground upon which these taxes may be condemned is found in the fact that they do not eliminate or even discourage directly the objectionable aspects of chain operation and may even encourage them.

One of the most popular theories advanced in support of chain store taxation follows the Brandeisian approach, condemning "bigness" in industry because it is big. It is extremely difficult to prove or disprove any general case for or against big business, but unfortunately for the proponents of chain taxation this does not seem to be necessary with regard to these taxes. The Indiana type of levy is the most popular form of chain tax, being in operation in all but three of the taxing states, and the Indiana form of tax discriminates against smaller chains, if located within one or a few states, as most are, and touches more lightly upon the large national chain with stores well scattered throughout the states. This method of taxation can scarcely be justified on the grounds of regulating big business if it

penalizes the bigger systems less severely than the smaller ones.

Closely related to this point is the following criticism: All of the chain taxes are based on the assumption that bigness and dominance may be measured by the number of stores under single control. The falseness of this position is apparent. A chain having comparatively few stores in certain fields, as witness the five- and ten-cent store chains, may obtain a tremendous volume of business from each unit and may furthermore realize a comparatively high margin of profit on these sales, while another chain, illustrated perhaps by stores in the grocery field, may have a great many units but obtain a smaller volume and a much narrower profit margin from each. The bigger chain is not necessarily the one with the largest number of stores, and yet all of these taxes, whether of the Louisiana or Indiana type, are predicated upon such an assumption.

One final criticism of these chain taxes, and one which appears to be equally true of nearly all types of trade-barrier legislation as well, is this: Such statutes are enacted to promote the interests of less efficient entities by imposing penalties and restrictions upon the more efficient, with the consuming public left to pay the bill.

Conclusion

In conclusion, it does not appear to matter a great deal whether the chain store taxing laws are considered as parts of the trade-barrier legislation. They are a product of the same basic philosophy; they are designed to enhance local interests without regard to public welfare; they restrict the free flow of products and of energies; and they are contrary to the principles of free enterprise. For all of these reasons they ought to be removed as quickly as possible.

CHAPTER XV

CHAIN STORE TAXES AS A TRADE BARRIER

A. R. Kaiser

General Manager, Tax Department, Sears, Roebuck and Co.

A tax which restricts the business done by chain stores at the expense of local consumers is a form of interstate trade barrier. Taxes like the one enacted in Louisiana, which is based on the number of stores operated throughout the country, are very effective interstate trade barriers. If a chain operating 99 stores in the United States, including stores in Louisiana, should open a new unit in Maine, the tax on each Louisiana store would immediately jump from $30 to $50 a store. What has been done to affect business in Louisiana when a new store is opened in Maine?

If the chain operated 500 stores in the United States, the tax would be $550 on each unit in Louisiana. The Kroger Company, in 1938, earned an average of $853 per store.[1] The company would sacrifice, therefore, approximately 64 per cent of its net revenue from each store in Louisiana as a payment to the state for the privilege of doing business as part of a nation-wide chain. In 1932, the Kroger chain earned only $347 per store. Therefore, the Louisiana tax would cause the average unit in Louisiana to operate at a loss of $203. This discriminatory legislation would soon accomplish its purpose of driving the chain stores from Louisiana.

As the size of the chain increases, the Louisiana tax be-

[1] *Standard Corporation Records.*

comes prohibitive and effectively closes the Louisiana market to the chain store. This type of tax is as effective in closing the market of the state to the chain stores as though a protective tariff were erected against the goods the chain stores sell.

Section 10, Article 1 of the Federal Constitution lays down the mandate that "No state without the consent of Congress shall lay any impost or duty on imports or exports." The chain store merchant who is barred from doing business in the state may well speculate on the import of this section of the Constitution when it is so easily circumvented.

Many states have chain store taxes, the amount of which is based solely on the number of stores within the state levying the tax. Although most of these taxes are not as rigorous as the Louisiana type, nevertheless, they are very effective interstate trade barriers, as they tend to close the state market to the nationally operated chain.

The chain store tax not only is a trade barrier against chains from without the state but is also a barrier to the consumers within the state. It discourages trade from without the state and restricts trade within the state.

The proponents of the Louisiana chain store tax would like to restrict the buying of Mrs. Smith, living in New Orleans, to independent retail stores exclusively. Mrs. Smith would, therefore, be penalized by paying higher prices for the goods she now purchases from chain stores, either if the chain store is barred from business in the state, or its cost of doing business in the state is increased by heavy chain store taxes.

However, Mrs. Brown, living in Little Rock, Arkansas, may buy where she pleases; and because there is no chain store tax there, she will obtain more value from her shopping dollar than Mrs. Smith in New Orleans. Thus the

chain store tax is an internal barrier which discriminates against the consumers of the state that imposes the tax, thereby decreasing the standard of living by increasing the cost of commodities.

Chief Justice Charles Evans Hughes summarized my views on interstate trade barriers much better than I could possibly do, when he said, "In confiding to Congress the power to regulate interstate commerce, the aim is to provide a free national market—to pull down and prevent the re-erection of state barriers to the free intercourse between the people of the states. That free intercourse was deemed and has proved essential to our national welfare. It should not be impaired."

CHAPTER XVI

CHAIN STORE TAXES AS A TRADE BARRIER

THEODORE CHRISTIANSON

The National Association of Retail Druggists

AT THE outset let me make the observation that it seems obvious that chain store taxes constitute a trade barrier but that the obvious is not necessarily true. A few lines in Genesis sufficed to make it obvious for more than two thousand years that all species of animals and plants came into being as the result of special creation; but Charles Darwin required a thousand pages to present the evidence which, for all time, proved that belief to be untenable. So I can hardly hope, in ten minutes, to overthrow the colossal assumption upon which the opponents of chain store taxation base their case.

You have just heard the general manager of the tax department of Sears, Roebuck and Company, and you were probably surprised to learn that he is opposed to trade barriers. You should be. I was. I was surprised because his expressed opinion was so completely at variance with the position the mail-order houses recently took in the state of Iowa.

You may recall that Iowa, like many other states, some years ago enacted a sales tax law. After it had been in effect for some time, it was discovered that it operated as a trade barrier. People who bought merchandise from their local merchants had to pay a tax which those who ordered goods from Sears, Roebuck and Company's Chicago plant escaped.

The legislature decided to remove that trade barrier against local merchants by levying a use tax, which placed customers of Chicago mail-order houses on the same basis as patrons of the local stores.

One would suppose that mail-order houses, as professed objectors to trade barriers, would have applauded this fair and meritorious measure. Did they? They did not. They went into the courts and recently obtained from the Supreme Court of Iowa a decision invalidating the use tax law. The so-called mass distributors of the country oppose trade barriers which hurt their business; they favor trade barriers which help their business.

That has always been the attitude of Big Business. Since 1789 it has supported the protective tariff, which is the greatest of all trade barriers. The protective tariff made Big Business big. But now certain important interests, represented largely by automobile manufacturers, find themselves in such complete control of the domestic market and so anxious to expand their sales abroad that they wish to lower tariffs, admit imported farm products, and thereby create credits abroad which can be used in purchasing automobiles, typewriters, cash registers, and other American gadgets.

Meanwhile, the farmers, with production costs reflecting factors which operate in any protected economy, have become protectionists. They cannot meet the competition of the cheap land, cheap labor, and cheap machinery of low-tariff countries; accordingly they demanded trade barriers against Argentine beef and corn, Cuban sugar and tobacco, and Philippine vegetable oils. They are unwilling to have these products admitted in order that there may be created a foreign market for American automobiles.

I agree wholeheartedly with these farmers; I agree with

New England textile manufacturers who want protection against Japanese competition; I agree with workingmen who refuse to accept wage scales determined by the cost of peon labor abroad. And, likewise, I agree with 1,500,000 independent merchants and their 4,000,000 employees who demand protection against the ravages wrought by a few so-called mass distributors that are already too big but want to become bigger.

If we were legislating in a vacuum, I probably should not favor a protective tariff; certainly I should not favor special taxes for any category of distributors. But we are not legislating in a vacuum. I have pointed out how a protective tariff for some has created a need for similar protection for others. Likewise, artificial advantages created by law have given some distributors means for monopolizing opportunity and crowding their competitors out of business, which must be counterbalanced, if the individual is not to be driven out of a field in which he has a prescriptive right by reason of previous occupancy.

One of those advantages is the corporate device, by which the capital of many individuals can be merged in enterprises against which an individually owned business cannot stand, and by which corporations can be consolidated into super-corporations with power so great as to challenge and even control governments. These corporations, by a strained interpretation of the Fourteenth Amendment, were invested with constitutional rights which had been intended for the protection of individuals only, and thereby were shielded from regulations which otherwise might have been invoked. By the decision in the Dartmouth College case, they were endowed with immortality. They can continue to grow and to aggrandize indefinitely, without being subject to the limi-

tation which death places on the wealth and power of individuals.

These are trade barriers with which you should be concerned—trade barriers which close the road for individual enterprise while leaving the highway broad and open for that legal fiction, the corporate person. These trade barriers were all created by law, and it does not violate any proper conception of the functions of government to insist that their evil effects should be modified by law.

The theory that the power of taxation should not be used to regulate business but only to raise revenue is not supported by American tradition, nor is the opposition to chain store taxation in conformity with accepted principles of taxation. It is axiomatic that taxes should be levied in accordance with the ability to pay. A system of taxation which taxes stores on the basis of their inventories on May 1, or some other date of assessment, does not meet that test. A chain which operates in 46 states, as Sears, Roebuck and Company does, can easily take advantage of the different dates in the different states and control inventories accordingly. I do not charge that that particular chain does—the important consideration is that it can. Furthermore, with the quick retail turnover possible for stores which have their own wholesale warehouses, where stocks can be procured quickly and in small lots without affecting quantity discounts and which, therefore, do not need to maintain large inventories, chains can avoid the heavy ad valorem assessments which inevitably fall upon the individual merchant, whose inventory in relation to volume is necessarily larger. The ability to pay taxes would be more fairly gauged by the volume of business done during the year than by the amount of the inventory on any one day of the year. The present ad valorem tax therefore imposes against the independent

merchant a trade barrier which a supplementary chain store tax is intended partly to remove.

I anticipate it will be said that a chain store tax based on the number of stores operated, instead of on their volume, does not completely satisfy the test I have laid down. That is true; and I would be the first to suggest a chain store tax levied on the basis of volume, if the chains, invoking the rules of constitutional interpretation to which I have alluded, had not succeeded in having chain store taxes based on volume held invalid. In view of the constitutional bar against the use of volume as the criterion, the number of stores which a chain operates is probably the best available measure of ability to pay.

Chain store taxation in any state does not deny to citizens of other states the rights and immunities enjoyed by citizens in that state, for the classification of chains for purposes of taxation is uniform, regardless of the domicile of the owner. If, for instance, a chain store corporation domiciled in Illinois and operating stores in Minnesota is taxed on the same basis in Minnesota as is a Minnesota corporation, there is no infringement, either in the letter of the law or in its spirit, of any constitutional right, and there is no interstate barrier. Those who contend that chain store tax laws which place the same burden on domestic as on foreign chains constitute interstate barriers could argue with equal force that the imposition of any tax, even a personal property tax, constitutes such a barrier.

If chain store taxes are a trade barrier at all, their operation as such is intrastate, not interstate. They are based on the right of the state to regulate its internal concern. If a state legislature can say that a corporation may not practice law, even to the extent of collecting a fee for drawing a will, who shall say that a state legislature is not equally within

its rights, and is equally justified, in pursuing the policy of favoring individuals, partnerships, and small corporations rather than great chains in the distribution of merchandise? To prevent undue concentration of economic power, and to use taxation in doing so, is not only legitimate but praiseworthy. It is an exercise of the state's right of self-defense, to stop further growth of corporations grown so big that their power approaches or exceeds that of the state itself.

The only defense offered for foreign ownership of stores is the claim that chain stores sell for less and thereby effect economies to the consumer. While there is an abundance of evidence with which to challenge that claim, the time limitation prevents me from presenting it here. Let it suffice to say that when chains sell at lower prices—outside the field of loss-leaders, where losses are recovered by marking up other goods—those lower prices are obtained by bringing to bear upon the producer the impact of overwhelming buying power. Bludgeoning tactics are employed, which have the result of lowering prices to uneconomic levels, both on the farm and in the factory, of increasing mechanization and unemployment, of impairing buying power, and, eventually, of collapsing the economic structure. To the extent that chain stores drive out independent competitors, they narrow the producers' opportunity to sell in a truly competitive market and thereby create the most menacing of all trade barriers.

In conclusion, let me point out that capitalism, in the broader meaning of the term, is a small man's economy. It superseded feudalism, which was a big man's economy. The emergence from feudalism into capitalism was accompanied by the rise of democracy—the ordinary man became important, and, being awakened to the sense of being *somebody*, he asserted his freedom in the political as well as in the eco-

nomic field. Forces theretofore unsuspected were set free—imagination, inventiveness, ambition. Millions found opportunity to achieve, and they threw themselves into the harness. They pulled the world forward as it had never gone forward before.

I am not saying that the impetus for achievement is gone; the movement gathered so much momentum that it is due to continue for some time. But I am saying that as control is being gathered into fewer and fewer hands, as the big rewards are going to smaller and smaller groups, as a handful of men are rising to feudal stature, capitalism is losing its momentum, and the process which carried us forward is being reversed.

In the earlier phases of capitalism, ownership and management were united; today they are being divorced. It is not of much significance that stock ownership is widely distributed. The important thing is that control is being concentrated. The real rewards go not to those who receive inconsequential dividends but to those who collect the richer returns of corporation management; and management is assuming, more and more, the aspects of a political bureaucracy.

When the final phase is reached, when all business is done on capital supplied by the masses and all control held by an irresponsible bureaucracy, capitalism will face its severest test. It will be but a step from that kind of capitalism to the collectivist state. All that will be involved in making the transition will be the substitution of commissars for directors—business can go on at the old stand. The form of organization can continue very much the same, but the substance—the thing which made the earlier capitalism the most dynamic force in history—will be gone.

This, of course, is speculation; but all who believe in

capitalism and abhor collectivism should be willing to give thought to the possibility. Using the power of taxation to stop the trend, to prevent the possibility from becoming an actuality, should not be rejected just because the idea runs counter to certain conceptions of the function of taxation. The trade barrier we need most to fear is a collectivism which will deny to all but the state itself the opportunity to engage in enterprise.

CHAPTER XVII

DISCRIMINATORY VENDOR LICENSING AND TAXING OF OUT-OF-STATE CORPORATIONS

CARL T. ARLT

Department of Economics, Oberlin College

THE major portion of this discussion will be devoted to discriminatory vendor licensing, in view of the more striking barrier aspects involved in such licensing. The discriminatory taxing of out-of-state corporations, on the other hand, seems to have been very much softened by constitutional limitations and the threat of retaliatory laws.

The emphasis on vendor licensing by states and municipalities has accompanied some very important changes in the marketing of goods. With the development of the automobile, improved highways, and a growing body of salesmen, direct selling has become a significant item in our marketing structure. National corporations distribute directly to consumers through door-to-door solicitors. Many concerns have found that the only way to push the sales of bakery products, ice cream, confectionery, salad dressing, tea, coffee, and yeast, is to have specialized salesmen traveling over a wide area, soliciting business directly from the consumer. Direct selling has constituted the one way in which some new brands have found their way into the markets. In the marketing of agricultural products, we find truckers picking up the goods and selling them in certain localities, either by parking their trucks and selling to customers as they pass

by or by driving from house to house. Laundries and dry cleaners have widened their markets by driving from town to town, picking up orders for their services. In short, there has developed a large group of itinerant vendors.

The foregoing developments represent a change in marketing institutions. The costly retailing establishments, expensive fixtures, heavy inventories are eliminated. In a sense, we have here an integration of marketing functions —an operation by a single business concern or individual of the processes and functions in two or more stages of distribution or production (a combination of salesmanship, transportation, retailing, etc.). Obviously, the established retailer, who is already facing a shrinking market because of other factors (chain stores, mail order houses, etc.), resents this type of marketing which cuts into a field previously monopolized by him.

With these marketing changes the element of fraud has been magnified. The seller who is "here today and gone tomorrow" is less responsible to the consumer than is the established merchant who maintains a fixed place of business within the town.

Out of the opposition of the established merchants and because of the necessity for some regulation, there has developed a flood of licensing or tax statutes aimed at those merchants who do not have an established place of business within the taxing district. Some states and municipalities distinguish between those who maintain a temporary business within the taxing district and those regarded as peddlers. Some distinguish between peddlers and itinerant truckers.[1] Others make no distinctions at all and merely put them all under the classification of itinerant vendors.

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[1] In 1939, 22 states considered bills affecting itinerant truckers. *See* F. E. Melder, *Trade Barriers and Peddlers.*

State Restriction of Vendors

What have the states done in the way of restricting such vendors? The states of Arizona, Florida, Georgia, Kentucky, Louisiana, Mississippi, Montana, Nebraska, New Jersey, Rhode Island, South Carolina, Virginia, Washington, and West Virginia are some which have particularly striking statutes involving restriction.[2]

There are several interesting features connected with these laws. With reference to merchant peddlers, the states of Arizona, Florida, Mississippi, Nebraska, Rhode Island, South Carolina, Virginia, Washington, and West Virginia require that the peddler pay a license fee in *every county* in which he operates. Such fees are imposed within the following range: Mississippi, $50-$100; Florida, $75; Rhode Island, $15-$50, depending on type of goods sold, also a state tax ranging from $60-$200; Nebraska, $25-$100; South Carolina, $25-$200; West Virginia, $15 per half ton truck, $250 for trucks over three tons; Washington, $300 (peddlers with motor vehicle); Arizona, $200 for merchant peddlers, $300-$500 for wholesale peddlers; and Virginia, $250-$500.[3] Such fees, which, in many cases, are levied on an annual basis regardless of the number of days the merchant peddler may actually spend in a county, most certainly tend to narrow the scope of direct selling.

In an attempt to regulate or discourage temporary dealers and tradesmen who rent space for a short time, states have imposed heavy license fees and regulations for posting of bonds. Kentucky, Louisiana, New Jersey, Rhode Island, and Virginia are some of the states which have fees up to

[2]Works Progress Administration, Marketing Laws Survey, *Comparative Charts of State Statutes Illustrating Barriers to Trade Between States.*
[3] *Ibid.*, pp. 3-19.

$250 *in each county* (Kentucky) or monthly fees up to $200 (Virginia) and bonds to be posted averaging from $500 to $1000. For instance, in Rhode Island, a transient merchant must post a bond of $1000, pay a license fee of $200 for three months, and pay an additional $100 if he operates in a town of less than 15,000 population or an additional fee of $350 if he operates in a town of more than 15,000.[4]

Another important feature of the vendor licensing is the exemption granted to farmers carrying their own produce, which, for all practical purposes, means local farmers, since the truckers who come great distances, specializing in trucking, usually do not carry their own produce. War veterans also fall into the exempt class, and in one state, South Carolina, we see a specific exemption granted to Confederate soldiers.

Municipal Restriction of Vendors

The peddler and the transient merchant must face not only the restrictions imposed by states and counties; he must cope with the municipalities. A great number of municipalities are allowed to *regulate* and *tax* different occupations, such powers being given to them by the state. Presumably, the license fee for regulatory purposes must not exceed the costs of regulation under the general police powers, but when the regulatory power is coupled with the taxing privilege, the combination gives the municipality wide scope for heavy fees on those against whom it wishes to discriminate. Of course, in order to tax one group of sellers differently from another group, the statute must establish a substantial difference in conditions for purposes of classification. Following is a picture of what the municipalities

[4] Works Progress Administration, Marketing Laws Survey, *A Digest of State Laws Relating to the Problem of Interstate Trade Barriers for States Whose Legislatures Convene in 1940*, p. 4.

STATE	CITY	ORDINANCE
Alabama	Huntsville	License fee of $300 on outside bakery and $100 on local bakeries. (*American Bakeries* v. *Huntsville*, 1936, 168 S. 880, 232 Ala. 612.)
California	Escondido	License fee of $50 per year for those engaged in business established within the city. $150 annually on the first truck, plus $25 for each additional one owned by firms established outside the city. (*Continental Baking Co.* v. *City of Escondido*, 89 Cal. Dec. 897, 69 Pac., 2nd, 181, 1937.)
Kentucky	Bowling Green	$25 fee on established dry cleaners within city. $200 fee on those having plants outside city limits. (*Williams* v. *Bowling Green*, 1934, 254 Ky. 11, 70 S.W., 2nd, 267.)
Michigan	Ann Arbor	License fee of $150 per year for each vehicle used by hawker or peddler. The fee, though somewhat large, was upheld since "peddling, though a lawful pursuit, is liable to become a nuisance." (*City of Ann Arbor* v. *Riksen*, 1938, 279 N.W. 513.)
Missouri	Harrisonville	License fee of $200 on baking company established outside the city. Local merchants exempt. However, one of the dissenting judges said, "The fact is that the purpose of this ordinance, masquerading in the guise of a revenue measure, and thinly veiled, is to cause appellant to cease selling its product to merchants in Harrisonville in competition with local producers . . . I therefore think the judgment below should be reversed." (*Campbell Baking Co.* v. *City of Harrisonville* 1931, 50 Fed., 2nd, 670.)
New Jersey	Asbury Park	Ordinance places $500 monthly license fee on itinerant vendors such as the seller of bankrupt stock who does not have an established business. (*Levin* v. *City of Asbury Park*, 1931, 154 A. 742.)
South Carolina	Bishopville	Outside wholesale merchant who makes only two trips a week is taxed $35, in accordance with the town occupations tax. The court admitted that the tax discriminated against the itinerant. (*Crosswell & Co. Inc.* v. *Town of Bishopville*, 1934, 172 S.E. 700.)
	Sumter	Bakeries with establishments outside the city must pay $50, while local units pay $25. (*American Bakeries Co.* v. *City of Sumter*, 1934, 174 S.E. 919.)

STATE	CITY	ORDINANCE
Virginia	Lynchburg	Imposed $300 license tax on nonresident laundry doing business in and out of the city, and a $50 license tax on local laundries. (*Linen Supply Co.* v. *Lynchburg*, 160 Va. 644, 169 S.E. 554.)
	Richmond	Ordinance imposed $150 license tax on nonresident laundries, plus $75 fee on each vehicle used by such laundry. (*Vaughan* v. *City of Richmond*, 1935, 165 Va. 145, 181 S.E. 372.)
Washington	Bremerton	Ordinance provided for the licensing of peddlers, fixing fee of $25 per month. This affected seriously the business of the Golden Rule Bakery Co., a corporation located in Seattle. (*Hastings et al.* v. *City of Bremerton*, 1930, 294 Pac. 553.)

have been doing in the way of restricting the person who has no established place of business within taxing district.

In addition to the cities listed, whose ordinances were upheld by the courts, we find that the cities of Denver, Omaha, Pittsburgh, Mobile, Baltimore, Cleveland, and St. Louis fix license fees of about $200 on itinerant merchants, with both Pittsburgh and St. Louis requiring $1000 bonds.[5] To get at the transient merchant who stays in town to conduct a transient business within a hired building or room, certain cities have imposed heavy license fees, for example, Grand Rapids, Michigan, a fee of $50 to $100 a month or fraction thereof, St. Louis, Missouri, $25 per day, and Youngstown, Ohio, a fee of $150 per day.[6]

To widen the picture a bit, we might mention a few city ordinances which have been invalidated by the courts, and yet even in their "invalidity" the following ordinances demonstrate the existence of the feeling of "protectionism" which seems to have arisen throughout the country.

[5] G. R. Taylor, E. L. Burtis and F. W. Waugh, *Barriers to Internal Trade in Farm Products,* a special report submitted to the Secretary of Agriculture, March, 1939, p. 59.

[6] *Ibid.,* p. 60.

STATE	CITY	ORDINANCE
Florida	St. Petersburg	With reference to auctions, the city imposed a license tax of $250 a day on transients, while established dealers need pay only $200 for period of 30 days. (*Dusenbury* v. *Chesney*, 1929, 97 Fla. 468, 121 So. 567.)
Georgia	Newnan	Required of laundries a license tax of $50 when work is done in city of Newnan but a tax of $300 when work is done outside the city. (*Atlanta Laundries Inc.* v. *City of Newnan*, 1932, 174 Ga. 99, 162 S.E. 497.)
Kansas	Humboldt	License fee of $120 per year on person not having established bakery in town. Fee of $10 on those having such an establishment. (*Hair* v. *City of Humboldt*, 1931, 133 Kans. 67, 299 Pac. 268.)
Missouri	Salisbury	Imposed annual license of $200 on nonresident sellers, as against $1.50–$7.50 on residents. (*Nafziger Bakery Co.* v. *City of Salisbury*, 1932, 48 S.W. 564.)
Nebraska	Fremont	Imposed license fee of $300 on outsiders. The court said that such an excessive fee "destroyed incentive to sell." (*Peterson Baking Co.* v. *Fremont*, 50 F. 680.)
	Wilber	License fee of $50 on outsiders and $5 on local merchants. (*Speirs Laundry Co.* v. *Wilber*, 1936, 269 N.W. 119.)
Oklahoma	Chickasha	Tax of $100 per year on hawkers, peddlers, itinerant merchants. This affected three baking companies delivering goods on standing orders to retail merchants. All merchants with fixed places of business in the town were exempt. (*Grantham* v. *Chickasha*, 1932, 156 Okla. 56, 9 Pac., 2nd, 747.)

Motivation

It must be emphasized at this point that the licensing and imposition of fees on itinerant vendors may be justified in so far as they protect people from fraud and cover the costs of regulation. And there is no reason why such vendors should not pay certain occupation taxes if the established merchants also pay taxes. But the evidence at hand seems to indicate that there is a widespread effort to deter and stifle itinerant vending. The fact that more than four

hundred cities in the United States have adopted the Green River type of ordinance,[7] which prohibits peddling on the basis of its being a nuisance, is ample proof of the fight against such vending. In fact, in much of the litigation over these ordinances, the opinion has been expressed that the aim of the municipalities is definitely discriminatory. In the case of *N. J. Good Humor* v. *Bd. of Commissioners of Borough of Bradley Beach,* the court said:

> It is therefore evident that the challenging municipal action was dictated by a purpose to shield the local shopkeepers from lawful competition, and thus to serve private interests in contravention of common rights.[8]

In commenting on the Green River type of ordinance passed in Orangeburg, Florida, the court said:

> The ordinance was passed by the city council of Orangeburg at the request of the Retail Merchants Association of that city, and not by reason of the complaint of householders. In fact, the matter of passage and enforcement of the ordinance does not appear to have been of import to the citizens . . . and when the appellant was arrested, it was not upon the complaint of any citizens, so far as the record discloses.[9]

When an ice cream vendor was fined by a court in Baltimore for violating a license statute, the chairman of the Maryland Pharmaceutical Association said the test case "provided the druggists with an excellent stepping stone towards curtailing, if not entirely eliminating, the injurious competition druggists are receiving from street vendors of ice cream."[10] I mention these comments made by different people to indicate that the problem is essentially a conflict between two types of distributors, the itinerant vendor versus the established retailer, and not merely an attempt

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[7] National Institute of Law Officers, *Opinion Bulletin Report,* No. 46, July, 1939.

[8] 11A. (2nd), p. 118.

[9] *City of Orangeburg* v. *Farmer,* 186 S.E. 785.

[10] "Ice Cream Vendor is Fined by Court in Baltimore Test," *Drug Topics,* June 26, 1939, p. 20.

on the part of municipalities to raise revenue, prevent fraud, and prohibit nuisances.

One more point needs to be stressed with reference to the licensing of itinerant vendors. If there are groups of retailers anxious to throttle the itinerant vendor, will such vendors find protection in the courts? To the extent that the courts demand that a proper classification be made for tax purposes, the scope of discriminatory taxes is narrowed, but we find that there is an increasing tendency on the part of the courts to assume that there is a substantial difference in the business conducted by itinerant vendors to warrant a classification for tax purposes separate from that of the established merchant. Once the classification is justified and declared legal, the amount of the tax is usually up to the legislature, although some courts have ruled against ordinances because the amount of the tax was too discriminatory.

If the municipality under its police power imposes a license fee for purposes of regulation, the license fee must be "obviously and largely beyond what is needed for the purpose intended before such legislation is declared void."[11] The fact that the fee may result in producing a revenue in excess of that required for regulation does not in itself destroy the regulatory character of a police measure.[12] The court tends to leave much to the discretion of the municipal authorities and presumes that the amount demanded is reasonable, particularly in the absence of evidence to the contrary.[13]

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[11] E. McQuillan, *Municipal Corporations,* Vol. 3, p. 483.

[12] *Ibid.,* p. 487.

[13] *See* the following cases: *City of Ann Arbor* v. *Riksen,* 284 Mich. 284, 279 N.W. 513; *State* v. *Harrington,* Vt., 68 Vt. 622, 35 Atl. 515; *A. & P. Tea Co.* v. *Spartanburg,* 170 S.C. 262, 170 S.E. 273; *Levin* v. *Asbury Park,* 154 Atl. 742; *Steur* v. *Atlanta,* 176 Ga. 433, 168 S.E. 7.

Such is the picture confronting the itinerant vendor. He is opposed by certain retailers' groups; the legislative authorities have the power to tax and regulate; the itinerant vendor and consumers have little influence in legislative halls; and the courts can offer little protection. The net result, therefore, happens to be a flood of licensing laws which, in their cumulative way, set up striking barriers to trade.

Taxing Out-of-State Corporations

A few words should be added concerning the taxing of out-of-state corporations. In fields other than insurance, the foreign corporation is, for the most part, protected against discriminatory tax burdens by the commerce clause of our Constitution and also by the desire of many states to induce business units to set up plants within their borders, in order to stimulate business activity and general employment.

In the field of insurance, which is not protected by the commerce clause, we see more evidence of this "protectionist" sentiment which is spreading over the United States. The discrimination assumes the form of a special tax on premiums collected, with the tax rate bearing more heavily on the foreign corporations than on the domestic. In fact, in some states (19 in 1937) resident life companies were entirely exempt from the premium taxes.

Discrimination may take another form in the insurance field. The states will have the same premium tax on both domestic and foreign corporations but will reduce or eliminate the premium tax rate for any company which has a certain proportion of its assets in the form of that state's bonds or other prescribed public securities. For instance, the law of the state of Mississippi states that if one-fifth of

the entire assets of the company are invested in Mississippi state or local bonds or loaned to Mississippi citizens, then the rate of premium tax will be reduced to one-third of that provided. Such a provision is quite discriminatory because of the fact that if any companies qualify under such provisions it will usually be the domestic company. It is unlikely that a foreign corporation will have such a proportion of its assets invested in this manner.

Admittedly, the foregoing points on the taxation of out-of-state corporations are very sketchy. They are included only to suggest that there may be an important barrier to trade involved in such legislation. Vendor licensing, however, to a very great extent, definitely belongs to that type of legislation which represents the attempts of certain organized groups to "freeze" themselves into the marketing structure at the expense of any new developments in the field of marketing, and, consequently, at the expense of the consumer, who, to this day, remains the "forgotten man."

CHAPTER XVIII

SALES AND USE TAXES AS BARRIERS TO TRADE—INTERSTATE AND INTRASTATE

Neil H. Jacoby

School of Business, University of Chicago

Barriers to trade between the states, no matter what form they take, usually do not absolutely stop the commerce at which they are directed. Ordinarily, they merely impede the flow of trade; they make the transaction of business more costly and less efficient; or they divert the flow of commerce away from its natural channels. Trade barriers are like Maginot Lines, which are thrown up to make it difficult or impossible for the opposing force to get through. In some cases the barriers are so high and effective that they cannot be penetrated directly; they can only be circumvented. That is to say, if the trade cannot surmount the barrier, it goes around it and is diverted into other less efficient channels. In other cases the barriers are so extensive that they cannot be circumvented, but they can be penetrated directly at a high enough cost. Rarely does it occur that trade barriers are both so extensive and so high that the trade at which they are aimed ceases altogether.

One may, then, broadly define a trade barrier as anything which either prevents trade from occurring, or which raises the cost of trading by altering the circumstances under which it occurs. In the absence of restrictions and regulations, it may be assumed that the forces of competition will

cause commerce to be conducted in the most efficient way, with minimum costs. Any law or regulation which changes the way in which trade occurs raises these costs. Thus, state laws regulating the sale or physical movement of liquor, oleomargarine, livestock, nursery products, dairy products, and other commodities, setting up preferences for products and labor of the home state, erecting ports of entry, or imposing sales and use taxes, are invariably and inevitably trade barriers.[1] They either prevent certain trade from occurring, or they raise the costs of trading to some degree.

The imposition of barriers to trade is, of course, justifiable and perfectly consistent with good public policy, if it promotes the health, safety, or welfare of the public. Merely to recognize that a given law or regulation is a trade barrier is not to condemn it. For a state to impose some limitations on the weight and length of trucks that traverse its highways, or to provide for the inspection of milk brought within it for consumption, is not deplorable. Public health and safety cost something to achieve, but they are worth some costs. It is proper to impose trade barriers, to the extent that the long-run costs of operating without them exceed the costs which they impose. The kind of trade barriers which do call for condemnation are those which merely prevent trade or raise its costs without providing any *quid pro quo*. These include barriers, set up under the cloak of the police powers of the states, which are really protectionistic in intent and effect. They also include state tax laws which impede a free flow of commerce throughout the federal union more than would the use of alternative sources of revenue preferable on other grounds.

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[1] *See Comparative Charts of State Statutes Illustrating Barriers to Trade Between States,* by the Marketing Laws Survey of WPA. *See also Barriers to Internal Trade in Farm Products,* a special report to the Secretary of Agriculture by the Bureau of Agricultural Economics.

Among state tax laws in this category fall state sales and use taxes.

State Sales and Use Taxes as Trade Barriers

State sales and use taxes are inevitably and invariably trade barriers of an unfortunate type. By raising the costs of goods to retailers and to consumers, they cause changes in the patterns of consumer expenditures and alterations in the total amounts of expenditure. They invariably divert trade from the channels it would follow in the absence of these taxes. Consumers spend their incomes somewhat differently than they would otherwise have spent them, because their urgencies (elasticities) of demand differ as between the commodities subjected to taxation. Business men alter their methods of doing business so as to minimize their tax payments. Economists generally describe these results as the "effects" of a tax. The essence of the matter is that sales and use taxes are cost-raising devices. Historically, they have for the most part been imposed in the American states during periods of expanding (inflationary) economic activity, and many of the adverse effects which would normally have appeared, such as failure of marginal business firms, have been concealed or offset by cyclical upswings in money incomes and employment.[2] When taxes of this type are first imposed during a period of falling business activity, their true economic nature becomes manifest. An excellent example was the cost-raising and employment-reducing effects of the social security payroll taxes—which are essentially similar to sales and use taxes—beginning in January of 1937. There is little doubt that these levies were significant contributory factors to the sharp business decline which occurred during 1937.

[2] Cf. Neil H. Jacoby, *Retail Sales Taxation,* pp. 323-30.

All taxes which are measured directly by the volume or value of productive effort affect its quantity. They erect barriers to the flow of trade and tend either to reduce its amount or alter its character. And this is true even though a uniform sales tax or use tax were to be imposed nationally by the federal government. It is a serious (and common) error to believe that the adverse trade-barrier effects of sales taxes upon the economic system inhere only in *state-imposed* sales taxes, and arise from the circumstance that all states do not levy sales taxes or because those that do levy them do not have equal rates of taxation. If this were the case, a federal sales tax would be unobjectionable. But such is far from the truth, as has been demonstrated. The trade-barrier effects of sales taxation go deeper than the mere differential trade advantages which are set up when state legislatures make levies at varying rates. It is true that state sales taxes *add* to the trade-barrier effects which a national sales tax would possess. It will be shown in this article, however, that the more recent use taxes have operated to reduce the differential trade advantages that the earlier sales taxes created, and, thus, taken collectively, use taxes have probably mitigated the trade-distorting effects of retail sales taxes. But on the other hand, use taxes have brought with them grave dangers of erecting new trade barriers.

Differential Trade Advantages Created by State Retail Sales Taxes

When reference is made to retail sales taxes as interstate trade barriers, most persons have in mind what might be called differential trade advantages, arising from the fact that the taxes imposed on a certain sale differ as between the states, causing consumers to buy in one state rather than

another. The differential may operate either in favor of buying at home, or it may operate in favor of buying in another state and thus stimulate interstate commerce. The latter result is often overlooked.

To simplify the argument, consider only two states, A and B. State A lays a 2 to 3 per cent sales tax on all retail sales of tangible commodities. Because of the added burden, some of its residents go to State B, which does not have a sales tax, and there purchase automobiles, which they bring into State A for use. While the automobile retailers of State A will properly regard the sales tax as a trade barrier, because it "barred" them from making certain sales, the auto retailers of State B find that their sales have increased. And interstate commerce has also very likely increased as a result of the tax of State A.

If State B should now impose a tax at the same rate as that of State A, some of the increased business of State B would disappear, since the differential trade advantage of State B over A with respect to intrastate sales of residents of A will be diminished. The trade-distorting effects of the sales taxes will not, however, have disappeared, for residents of A will be able to import goods from B in interstate commerce free of B's tax. Also, a new differential in favor of interstate commerce will appear as a result of the tax in State B. Residents of State B, who theretofore had no tax incentive to buy in State A, will now transfer some of their purchases to State A, in order to buy in interstate commerce goods which will move to them in State B.

The net result of both taxes jointly will probably be that interstate commerce has increased. But the increase is not, of course, a healthy one based upon differences in real economic costs as between the states. Consumers will be put to some trouble and expense in doing business with different

vendors at a distance. Furthermore, there will be wasteful cross-transportation of goods whenever the saving in tax payments exceeds the trouble and transportation costs of getting them free of tax in another state.

We have, then, the paradox that the total volume of interstate commerce has increased, while at the same time trade barriers—in the real sense—have been imposed by both States A and B. The fact that both States A and B are precluded by the United States Constitution from laying a direct burden on interstate commerce has really resulted in creating a discrimination in favor of interstate commerce and against intrastate business.

Reduction of Differential Trade Advantages by Recent Court Decisions

While it is not the present purpose to describe in detail the development of legal doctrines which permit this sort of differential trade advantages in favor of interstate commerce, it may be observed that recent decisions of the United States Supreme Court have greatly narrowed the scope for avoidance of state sales through the transaction of business in interstate commerce. Retailers outside a sales tax state have always been able to solicit business by mail or telephone from consumers in that state and to ship goods into it without being liable to pay the sales tax. Even retailers having places of business within the taxing state were, up to 1935, able to escape a sales tax by having goods delivered directly from an out-of-state source to the consumer in the taxing state. The first step toward closing the doors of interstate commerce to sales tax avoiders was taken in the *Wiloil Corporation* decision in 1935, when it was held that a retailer in a taxing state must be *required under his contract of sale* to obtain the property outside the state and

to make an interstate shipment therein in order to complete the sale, before the tax could be properly escaped.[3] By taxing a retail vendor if he were free to perform his contract of sale by delivery of goods from stocks within the taxing state, this decision definitely lessened the scope of avoidance, in theory. But in practice it was easy for vendors to avoid taxation merely by agreeing with purchasers to meet the formal requirements of contractual necessity for an interstate shipment to complete the sale.

The second important step toward expanding the application of state retail sales taxes to sales in interstate commerce was taken early in 1940, when the Supreme Court handed down decisions in the notable *Berwind-White* and associated cases.[4] The Berwind-White Coal Mining Company was held liable for the New York City sales tax on sales of coal delivered in New York City from its mines in Pennsylvania, even though the sales contracts specifically called for delivery from points outside New York City. In the associated *Felt and Tarrant* case the Court went even farther. Felt and Tarrant Company had merely a sales office in New York City, from which its salesmen solicited orders. The orders were accepted at the home office of the company in Illinois, the goods manufactured in Illinois, and then shipped to the New York office for testing and delivery to customers. One might have concluded that the fact that the goods came to rest in the hands of the vendor in New York City was the distinguishing characteristic, if it were not for the third case in this pathbreaking series justifying a

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[3] *Wiloil Corporation* v. *Commonwealth of Pennsylvania*, 294 U. S. 169 (1935). Cf. discussion of this case in the author's *Retail Sales Taxation*, pp. 142-44.

[4] *McGoldrick* v. *Berwind-White Coal Mining Company*, 309 U. S. 33; *McGoldrick* v. *Felt and Tarrant Manufacturing Company*; *McGoldrick* v. *A. H. Du Grenier, Inc.*, 309 U. S. 70; *Jagels "A Fuel Corporation"* v. *Taylor* (January 29, 1940).

New York City tax—that of *Du Grenier, Inc.* Du Grenier, Inc. had a sales office only in New York City and sent its orders to Massachusetts for acceptance and manufacture of the goods. The New York City purchaser apparently took title to the goods at the Massachusetts factory, for the purchasers paid the freight and the goods were shipped directly to them in New York City. Yet the sales were held taxable.

At the present time it appears that any sale involving movement of goods into a sales tax state to a consumer can be taxed if only the vendor comes within the jurisdiction of the state. Evidently the Supreme Court has now gone as far as it can to allow the state of consumption to impose its retail sales taxes on goods coming in from other states. But even this does not catch the mail-order or telephone seller who does business in a sales tax state but who is shrewd enough not to have an office or establishment there sufficient to give the state jurisdiction. For him is reserved stronger medicine—the use tax.

Reduction of Sales Tax Trade Differential Advantages by Use Taxation

The fundamental trade-distorting effects of sales taxes apparently pass unchallenged by most consumers. It is only when some producer or business group is adversely affected that remedial action is likely to follow quickly. The failure of retail sales taxes to reach merchandise moving in from other states soon caused organized and articulate business groups to clamor for legislative relief. New York City met the demand by imposing a special personal property tax of 2 per cent on enumerated classes of personalty upon which a sales tax had not been paid. Illinois aided its automobile dealers by charging a $15 fee for "investigating" the title to automobiles purchased from dealers outside the state—a curious piece of legislation which

would probably be held invalid if challenged in the courts. But the great majority of sales tax states have, since 1935, imposed supplementary use taxes. Theoretically, these levies tax every user or consumer of tangible commodities, the seller of which has not paid the sales tax of the state.

There can be little doubt that use taxes have been partially effective in taxing sales escaping sales taxes and in discouraging purchases outside a taxing state in order to save a sales tax. Despite the impracticability of collecting them completely, they have done much to eliminate those differential trade advantages in favor of interstate commerce which sales taxes created. The revenues which they yield afford no measure of their effect, because one can never know how much interstate commerce was discouraged (i.e., never occurred) because of their existence. Their relative completeness of collection would be greatly improved if the large mail order houses could be compelled to remit use taxes on goods shipped into use tax states. This the Iowa Supreme Court prevented in its decision in *Sears, Roebuck and Company* v. *Roddewig et al.,*[5] holding that the "mail order sales . . . do not constitute activities within the state of Iowa." This decision hardly seems consistent with the pronouncements of the United States Supreme Court in the *Du Grenier* and *Jagels* cases mentioned previously, and it remains to be seen what will be its judgment on this use tax question.[6]

Creation of New Differential Trade Advantages by Use Taxes

While use taxes have been intended to remove the trade distortions created by sales taxes, and have generally oper-

[5] Iowa Supreme Court, May 14, 1940.

[6] Since the preceding remark was written the United States Supreme Court has reversed the decision of the Iowa court and held the mail order house liable for collection and payment of use taxes.

ated with this result, they also harbor dangerous possibilities of setting up new differentials, which—unlike those of sales taxes—cannot be cured.

One obvious trade barrier occurs when a resident of State A purchases an article in State B and pays its sales tax; then he returns to State A and finds himself liable for a use tax. The use tax of State A should operate so as to take the profit out of buying in other states for the purpose of avoiding the sales tax of State A. It should not prevent buying in other states done for other purposes than tax avoidance. In this case the purchase of goods in another state is penalized by the sales tax-use tax combination. There results an undesirable distortion of trade from its natural form.

It is true that the legislatures of many states have recognized this evil and have wisely sought to prevent or minimize it by exempting from use taxation goods upon which a sales tax of equal amount has been paid in another state. A majority of the states now imposing use taxes have such "offset" features. All state use tax laws should contain them. Certain states (Iowa and Wyoming) try to avoid discrimination against out-of-state buying by exempting from their own use taxes goods "not readily obtainable" within the state. But, clearly, it is an impossible administrative task—to be performed at best by making a series of arbitrary judgments—to determine whether incoming merchandise could "readily" have been obtained within the state. The comprehensive "offset" provision operates far more effectively to reduce discrimination against out-of-state buying.

If all states levied both sales taxes of equal rate and use taxes with offset features, no differential trade advantage would be created. All sales for consumption would be taxed

once and at the same rate. The only trade-barrier effects would be those inhering in any sales tax, even though national in scope. But this condition would probably not be soon achieved, for several reasons:

(1) Revenue and expenditure requirements of the several states differ. Hence, all states do not levy sales taxes, and those that do, impose them at unequal rates.

(2) Constitutional provisions in some states, such as Illinois, apparently prevent the levy of a use tax, and therefore preclude action to remedy the differential trade advantages created by the sales tax.

(3) Judicial interpretations may create the possibility of double taxation of an interstate transaction.

The United States Supreme Court is evidencing a disposition to allow the state wherein goods are consumed to impose its use or sales tax. Thus, in the *Du Grenier* case referred to previously, it appears that both legal title and physical possession of the goods were acquired by the New York consumer in the state of Massachusetts. Yet the city of New York was permitted to impose its sales tax on the Du Grenier Company (the vendor) because the goods were transported into New York City for consumption. One cannot disagree with the economic principle involved. Yet it would appear that the Court must clarify some of its rulings in earlier cases, in order to preclude the levy of a sales tax by Massachusetts upon this transaction, and thus prevent the sale value of property from being the subject of sales or use taxation *both* by the state out of which, and the state into which, it moves.

In conclusion, it seems accurate to say that use taxation has, on balance, reduced the differential trade advantages which existed in the early days of state retail sales taxation. It has not eliminated them, because some states have not (or cannot) levy use taxes, and because all states which do levy use taxes do not exempt property which has paid the

sales tax of another state. So long as we are to have state retail sales taxes with us—and the end is certainly not in sight—it would appear desirable that all sales tax states impose use taxes. In a deeper and more fundamental sense, however, sales taxation which is completely supplemented by use taxation still contains trade-distorting effects which constitute undesirable trade barriers. To eliminate these barriers, the only course is repeal of the whole system of sales and use taxation and their replacement with less burdensome, and more equitable, state levies. Such a replacement program, of course, raises important fiscal problems which lie beyond the scope of the present discussion.

CHAPTER XIX

IS THE USE TAX A TRADE BARRIER?

Lawrence Leslie Waters

School of Business, University of Kansas

In connection with the consequences of a federal sales tax on trade in general or a sales tax on intrastate trade, the effect is, of course, from the consumers' viewpoint, an increase in price of goods. Less goods can be purchased. With a declining volume, the marginal firms are forced out of business. Sales of necessities weaken, while a disproportionate decline in volume occurs in concerns producing goods of secondary importance to wage earners. Presumably, the well-to-do would continue to indulge themselves at the expense of savings. If the proceeds from the tax were distributed to the well-known one-third of our population, then demand for necessities would be bolstered somewhat.

Granted that sales taxes deter trade, can anyone think of another source of revenue for the states which would not show repercussions on volume? Assume that income taxes displaced sales taxes. We think of the income tax as incapable of being shifted, with the full incidence resting on the taxpayer. Undoubtedly, most of us have felt the burden of the federal income tax in the last year or two; yet a stronger test is being prepared. If the taxpayer were to pay an increased amount to the state in the form of income taxes or any other taxes, he would have less to spend, and the volume of his purchases would decline. The outline of the effects would not be exactly like those of a sales

tax, but some similarity would exist. It would take an income tax with low exemptions and regressive rates to duplicate the consequences of a sales tax very closely. One must figure, then, how much more a sales tax hampers trade in excess of the other taxes that would surely be adopted to fill the breach.

With regard to the differential trade advantages offered in interstate commerce if a sales tax is unattended by a use tax, an interesting study was made by the Tax Survey Commission of North Dakota to ascertain the amount of tax avoidance.[1] This survey was undertaken in Grand Forks and Fargo, and the method of research was a house-to-house canvass of 711 households in Fargo and 209 in Grand Forks. Each of these cities is opposite a smaller city in Minnesota. The conclusions are embodied in the following excerpts from the report:

> . . . the fears of merchants in border towns that their business would be affected by a tax on retail sales are largely justified. While the effect upon business is not pronounced or serious when the rate of the tax is moderate, it is evident that if the tax were very much higher, out-of-state buying, in nearby towns over the state line or from mail order houses, would be disconcerting. For example, during the first month the sales tax was in operation, approximately 6 per cent of the households in the cities of Grand Forks and Fargo did some shopping in nearby towns in Minnesota, or made up orders large enough to justify delivery by Minnesota merchants, because of the state's 2 per cent retail sales tax. . . . The survey indicated that approximately 85 per cent of the out-of-state buying by residents of Grand Forks and Fargo on account of the sales tax between May 15th and June 15, 1935, went to the grocery stores of Moorhead and East Grand Forks, Minnesota. Information obtained from 920 heads of households in Grand Forks and Fargo revealed that approximately 2½ per cent of the total food business shifted across the state line to these border towns. Other lines of merchandise affected, most of them only slightly during the period covered, were

[1] *Report of the Tax Survey Commission on North Dakota's Tax System and Its Administration,* No. 7, 1936, pp. 108-109. The investigation was made between May 15 and June 15, 1935. The 2 per cent sales tax had become effective on May 1, 1935.

furniture, high-priced electrical equipment such as refrigerators, men's and women's clothing, hardware, paint, and motor oil.

It is estimated that 20 per cent of the purchases of motor cars by residents of Kansas City, Missouri, which has a sales tax, have moved over to Kansas City, Kansas. The shunting of other commerce has been almost as impressive. Most avoidance occurs on major purchases. Adoption of use taxes has tended to convert tax avoiders into tax evaders. It is true that the coverage on automobiles is complete. Large domestic corporations and foreign corporations with local offices offer few problems. The remainder of the transactions are in a different category. It is not so much the fault of administrators as it is the nature of the tax. To assume that the situation in Kansas is typical of all the states with use taxes is probably unscientific and inconsistent with the national conception of the state, but the ignorance which prevails with regard to the existence of the levy is difficult to believe. Scarcely 10 per cent know of the tax, and less than that would conform if they did know of it. The large income from the use tax derived from the few readily taxable sources does not invalidate the statement that interstate commerce has been stimulated considerably at the expense of intrastate.

Use taxes are trade barriers, but they are desirable if the sales taxes are retained. Use taxes do not represent a discriminatory obstruction and, as a generalization, they bear upon interstate commerce just as a sales tax rests on intrastate commerce.

In addition to the possibility of double taxation, there is the significant point, regarding use taxes and trade barriers, that consumers resent the levies because of established views concerning the commerce clause (but not justice in taxation). They resent a payment for the "use" of

something. They further resent paying a tax to a foreign corporation. To the extent that this feeling overshadows the attitude toward a sales tax on an intrastate transaction, the out-of-state company is injured.

The requirement that the seller act as the agent of the state involves some expense on the part of the foreign company for which it may not be reimbursed. This outlay may be compared to the cost of collection of the sales tax by the domestic concern, thereby leaving no inequitable load on the former. The allowance of 2 to 3 per cent for cost of collection is a rather expedient policy for aiding collection.

In some states there is warranted criticism of use taxes as trade barriers in a few special cases. If used machinery is brought into the state, the tax must be paid on the original purchase price. If the machinery were recently purchased, the tax would be low, but if purchased and used outside the state, then the value for tax purposes would ignore depreciation. The generalization, however, still stands that use taxes (accompanying sales taxes) are not a discriminatory obstruction to interstate trade. This is not an argument, however, for retention of the sales tax which has made the use tax necessary.

PART FIVE

TAX BARRIERS TO INTERNATIONAL TRADE

CHAPTER XX

HISTORY OF MOVEMENT TO REMOVE TAX BARRIERS TO INTERNATIONAL TRADE

MITCHELL B. CARROLL

Counsellor at Law, New York; and Acting Chairman, Fiscal Committee, League of Nations

THE fact that taxes may constitute a serious barrier to international trade has long been realized. The Dutch, pioneers in discoveries, were perhaps the first on record to conclude that it was the better part of wisdom to forego an obstructive levy, in order to derive greater benefits from the freer commerce that resulted. On May 21, 1819, the Netherlands promulgated a law which exempted, on condition of reciprocity, foreign ships from its business license tax. This tax was considered an obstacle to commerce even though it was imposed only on the basis of certain factors in the taxing country, such as the rent paid or the number of employees.

The problem grew more serious when business enterprises were subjected to taxes on the same income or property in two or more countries. The income tax was first introduced by the United Kingdom during the wars against Napoleon, but later it was made a permanent levy. During the course of the nineteenth century, various continental countries adopted such an impost as a convenient means of raising revenue. The Netherlands Government, preoccupied with the development of commerce in its colonies in the East and West Indies and elsewhere, sensed the restrictive effect of

having to pay tax both in the country where income was derived and again in the country where the recipient resided. That government decided that if it gave relief from its own tax the traders would bring home their foreign earnings and thereby increase the wealth of the country. Hence, in 1893, an individual taxpayer deriving income from a colony or a foreign country was allowed to deduct from the graduated tax payable to the Netherlands Government the tax he would have to pay if his net income were equal to that which he received in the colony or foreign country.[1]

When the activities of individuals were largely superseded by corporations, the Dutch Government, in 1918, allowed a domestic company to deduct from its distributed income, upon which the home tax was levied, two-thirds of that part of the distributed income which corresponded to foreign profits.[2]

In 1906, Belgium had given its enterprises a somewhat greater incentive to compete abroad by authorizing a reduction of three-fourths in its rate applicable to income derived from foreign sources.[3]

The Dutch and Belgian measures were applicable in respect of income from all countries. When the United Kingdom felt the necessity of keeping up trade during the first world war, it followed their example in 1916, but only with regard to countries within the Empire. This measure was replaced by the so-called dominion income tax relief which is still in effect.[4] Accordingly, individuals or companies resi-

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[1] League of Nations, *Taxation of Foreign and National Enterprises*, Vol. II, p. 34.

[2] League of Nations, *Double Taxation and Fiscal Evasion: Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion*, Vol. I, p. 197.

[3] League of Nations Document F. 212, p. 11.

[4] Sec. 43, Finance Act of 1916, reproduced in sec. 55 of the Income Tax Act of 1918, replaced by sec. 27, Finance Act of 1920, as amended by the Finance Act of 1927, sched. V, part II, par. 2 (iii).

dent in the United Kingdom are allowed to deduct from their United Kingdom tax the dominion tax on income from local sources, provided it does not exceed half the United Kingdom rate; otherwise, the dominion itself is supposed to forego the amount by which its rate is in excess of half the United Kingdom rate, thereby completing relief from double taxation. In practice, the various dominions have, for the most part, kept their rates at less than one-half the British rate.

As regards trade with countries outside the British Commonwealth of Nations, another provision of the United Kingdom income tax act[5] is construed to free from tax profits from a business managed and controlled abroad unless they are remitted to the United Kingdom. Obviously, such a provision tends to encourage the retention of profits abroad in the development of separately managed businesses.

In 1917 France, in revising its income tax system, adopted the principle of taxing industrial and commercial profits only if allocable to a permanent establishment in France, thereby exempting profits attributable to an establishment abroad.

In contrast to the foregoing unilateral measures, Prussia and Austria-Hungary in 1899 set the example of negotiating a bilateral treaty for the prevention of double taxation, which was followed by a number of similar treaties between Central European States.

American enterprises suffered in competing with enterprises of countries which enjoyed relief from double taxation such as that previously described. You can imagine the deterring effect on foreign trade and investments when taxes mounted to such heights that the accumulation of rates,

[5] Rule 2, case V, sched. D, Income Tax Act of 1918.

especially if surtaxes were involved, sometimes equalled or even exceeded the income involved. Hence, in 1918, our government adopted an essentially similar system of relief. It consisted in allowing a credit against the United States tax on entire net income for taxes paid to foreign countries on income from sources in their territories. In 1921 a limitation was added to prevent any reduction of the United States tax on income from domestic sources, in cases where the foreign tax rate was higher than the United States rate. The effect of the credit provisions as amended is, broadly speaking, to exempt the income from a foreign country where the rate of such country is as high as or higher than the United States rate. When the foreign rate is lower than the American rate, the foreign income is taxed in the United States only to the extent of the excess of the American rate over the foreign rate.[6]

In 1921, the United States also offered to exempt foreign shipping enterprises on a reciprocal basis, and this offer has since been accepted by practically all maritime countries.[7]

Italy soon followed the example of France in exempting an Italian enterprise on income allocable to an establishment abroad. Essentially similar provisions were found in the laws of Central European States, various Swiss cantons, and some other countries. It is to be noted that, for the most part, the home country granted the relief regardless of what other countries did. That is to say, the home country, in order to encourage the taxpayers to run the risks of operating abroad, acknowledged the prior right of the foreign country where sales were made to tax the income so derived. Although the home country gave up all or part of its own tax on the foreign income in the first instance, it

[6] Sec. 131, Internal Revenue Code.
[7] *See* secs. 212(b) and 231(d), Internal Revenue Code.

could recoup by collecting tax when the income from abroad was passed on to become a part of the taxable income of others, including suppliers of goods to the exporting enterprise, employees, and shareholders.

On the contrary, foreign enterprises which ventured into some of the countries mentioned to compete with national entrepreneurs were often charged with all the traffic could bear. When they countered by pricing their goods or services at such a figure that little or no profit appeared in the books of the sales branch or subsidiary, the tax authorities resorted to various forms of arbitrary assessments. Some even extended the fiscal arm to reach the mother or grandmother corporation abroad. Often these methods devised to frustrate tax avoiders were applied as well to perfectly honest taxpayers. Governments were supposed to be at peace with each other, but, in some cases, their fiscal authorities carried on a fairly effective war against the foreigners who, figuratively speaking, invaded their markets.

Firms engaged in international business pointed out the barriers to trade resulting from double taxation at the organization meeting of the International Chamber of Commerce held in Atlantic City in 1919. At the first congress of that organization, in 1920, the prevention of double taxation was placed on the agenda and has since constituted the work of its standing committee on the subject.

Likewise, in 1920 the International Financial Congress held in Brussels recommended that the League of Nations study methods of eliminating the multiple taxation of the same income or property.

Initiation of League Studies

In response to these appeals, the Financial Committee of the League asked four prominent economists of Italy, the

Netherlands, the United Kingdom, and the United States (Professor Seligman of Columbia University) to study the effects of double taxation from a theoretical viewpoint. The report, dated April 3, 1923,[8] defines the extent to which double taxation may be a burden on existing economic rewards or an interference with new or potential business intercourse. In the latter connection, it shows how a tax imposed on interest in the country of the borrower must ordinarily be assumed by the borrower, therefore constituting a barrier to the flow of capital.

The report also propounds the doctrine of economic allegiance, under which "a part of the total sum (of taxes) paid according to the ability of a person ought to reach the competing authorities according to the economic interest under each authority. The ideal solution is that the individual's whole faculty should be taxed, but that it should be taxed only once, and that the liability should be divided among the tax districts according to his relative interests in each."

In determining economic allegiance, the report stated that the most important factors are: (1) the origin of the wealth; and (2) the residence or domicile of the owner who consumes the wealth.

The report surveyed briefly the systems of taxation in various countries and placed them in three broad categories:

1. Countries which have separate taxes upon things and upon different objects of wealth (such as the pre-war-of-1914 *impôts réels* of France and Belgium, and the *Ertragssteurern* of the German states);
2. Those which have a system of taxation upon separate sources of income which are often supplemented by a progressive tax upon total income (such as the various *impôts cédulaires* and the general income tax of France, and a similar classification of taxes in Italy);
3. Countries which have a pure income tax imposed on the entire

[8] League of Nations Document E.F.S.73.F.19.

net income of citizens or resident individuals, but only on income from domestic sources in the case of nonresidents (as, for example, in the United Kingdom, Germany and the Netherlands, and the United States).

After discussing the economic allegiance of various classes of wealth for purposes of taxation and suggesting certain methods of preventing double taxation, the report reaches the following conclusion: The most practical and desirable way of avoiding its evils is for the country of origin of income to exempt all nonresidents from taxation on income derived from sources within its borders, as this would have the effect of increasing the flow of capital from abroad and the development of less favored regions. If, however, countries are reluctant to abandon the principle of taxation at origin, the report suggests the limiting of origin taxation to broad classes of investment such as rents and mortgages on real property but the exempting at origin of nonresidents in respect of income derived from business securities. The report adds that this method might be modified by adaptations along the lines of the British dominion income tax relief.

Even before the publication of this report, the Financial Committee of the League, in June, 1922, entrusted the study of the matter from an administrative and practical viewpoint to a group of high officials in the tax administrations of seven European countries (Belgium, Czechoslovakia, France, Italy, the Netherlands, Switzerland, and the United Kingdom). This committee understood its task to be the bringing about of a more equitable assignment of taxation to prevent the evil effects of double taxation and to check tax evasion.

It recognized, however, that no change could be made in the then condition of affairs without some modification of

domestic legislation of the various countries or without international conventions. After five sessions, this committee of technical experts issued, on February 7, 1925, a report and resolutions,[9] and the Committee was then enlarged to include experts from Argentina, Germany, Japan, Poland, and Venezuela.

Its third session, in 1927, was the first in which an American participated, the late Dr. T. S. Adams. It was my good fortune to accompany him, and I can vividly recall that meeting in Somerset House on the Strand. Despite the misunderstandings resulting from differences in concepts and in language, this group formulated four model conventions for the prevention of double taxation, the first dealing with income and property taxes, the second with succession duties, the third with administrative assistance in matters of taxation, and the fourth with judicial assistance in the collection of taxes.[10]

The Council of the League then had the report distributed to the governments of all States, whether or not members of the League, with the request that they express their opinions on its contents and send representatives to a general meeting of government experts, in 1928, for the purpose of discussing the report.

Meeting of Experts in 1928

The meeting opened at Geneva on October 22, 1928 and 27 different countries were represented. Members of the International Chamber of Commerce attended in an advisory capacity. It is interesting to note that the countries which had not previously participated included Austria,

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[9] League of Nations Document F. 212.

[10] Report of April, 1927, League of Nations Document G. 216. M. 85. 1927. II.

Bulgaria, China, Danzig, Denmark, Estonia, Greece, Hungary, Irish Free State, Latvia, Norway, Rumania, Union of South Africa, Spain, Sweden, and the Union of Soviet Socialist Republics. However, no Latin American country was represented.

The goal was to agree on model conventions which could be adopted by all the participants. It was again my privilege to accompany Dr. Adams, and I wish I could depict the intense and often dramatic scenes in which tax administrators fought for their right to tax as they saw it, while the representatives of business looked on and occasionally raised their voice in protest. The conflicting claims to levies on interest and dividends by debtor and creditor countries, and the wide differences in tax systems, made it necessary to replace the one model convention concerning income taxes by three. Nevertheless, there was an amazing basic unanimity of opinion among the representatives of the various countries, and even the experts of the International Chamber praised, for the most part, the results of the meeting.

Model Conventions to Prevent Double Income Taxation

Briefly, the three conventions followed the same classifications of income, and for the most part the same definitions of their respective sources,[11] as follows:

1. Income from immovable property and mortgages; the source is the country in which such property is situated.
2. Income from an industrial, commercial or agricultural undertaking; the source is the permanent establishment at which such income is produced.
3. Fees of managers and directors; the source is the country in which the undertaking has its real center of management.

[11] *Report of the General Meeting of Government Experts on Double Taxation and Tax Evasion,* October, 1928, League of Nations Document C. 562. M. 178. 1928 II.

4. Salaries, wages, and other remunerations; the source is the country in which the employment is carried on.
5. Salaries of public officials and employees; the source is the paying government.
6. Interest on government bonds, corporate bonds, including mortgage bonds, loans and deposits or current accounts; the source is the country in which the debtor is resident.
7. Dividends on shares or similar interests; the source is the real center of management of the corporation.
8. Public or private pensions; the source is the debtor of such income.

Annuities or income from other sources not previously mentioned are in all three conventions taxable only in the State of fiscal domicile of the creditor.

For the purposes of the three conventions, an individual has his fiscal domicile at his normal residence, that is to say, his permanent home. For legal entities, the fiscal domicile is defined as the place where they have the real center of management, rather than the location of their statutory head office. Although in most instances the two are in the same State, the experts selected the concept of real center of management, which corresponds to the British test of the place where the "brain, management, and control of the business are situated," because they believed that the adoption of this concept would tend to deter companies from transferring their nominal headquarters to a country with lower taxes.

Apart from exceptions of relatively minor importance, the mechanism for preventing double taxation under the three model conventions is as follows:

1. Model convention 1(a), which is an amended draft of the convention elaborated by the previous committees of experts, presupposes that each contracting State has a tax system composed of impersonal or *cédulaire* taxes on income from specific sources, and a superimposed general income tax on total income from all sources. In general, its articles provide that income from the various sources listed above is to be subject only to impersonal or *cédulaire* taxes in the

country of source, and only to the personal or general income tax on entire net income in the country of fiscal domicile.

2. Under model convention 1(b), which was proposed by the American experts and supported by the delegates of Great Britain, Norway, and Sweden, all income is to be taxed at the fiscal domicile of the recipient, except that certain categories of income are to be taxed by priority in the country of source, namely, income from immovable property, profits from industrial, commercial or agricultural undertakings, fees of managers and directors, and salaries and wages. The tax thus imposed in the country of source is allowable as a credit against the tax on entire net income at the fiscal domicile of the recipient. The income taxable in the first instance at source would be protected from double taxation by a device similar to the credit for foreign taxes now found in section 131 of our Internal Revenue Code. The other categories of income, consisting mostly of interest and dividends, would be exempt at source and taxable only at the creditor's residence. The flow of capital to countries in need of economic development would thereby be stimulated.

3. Under convention 1(c) which, curiously enough, was a compromise between projects proposed by the French and German experts, practically all categories of income are taxable only in the country of source. In principle, however, the income from securities is taxable at fiscal domicile unless the State of source wishes to continue to apply a withholding tax, in which case it is suggested that double taxation be prevented either by a refund of the withheld tax or a credit of said tax against the tax at fiscal domicile. A basket clause provides for the taxation of annuities and other income not specifically mentioned at the fiscal domicile of the recipient.

All three conventions provided that income from a shipping or air navigation enterprise should be taxable only at the real center of management of the enterprise. The provisions of conventions 1(a) and 1(c) are stated to apply *mutatis mutandis* to taxes on property.

The previously drafted model conventions on the prevention of double inheritance taxes and mutual administrative and judicial assistance in the assessment and collection of taxes were adopted with minor amendments by the 1928 meeting.

Work of Fiscal Committee

Realizing that much remained to be done, the general meeting of government experts recommended that the League appoint a permanent Fiscal Committee. This group met for the first time in October, 1929. It was composed of titular members from the leading countries of Europe and the United States, and corresponding members from most of the remaining European countries, and overseas countries in the British Commonwealth of Nations, Latin America, and the Near and Far East.

One of the first subjects to be examined was of special importance because, during the 1920's, a number of administrations had endeavored to tax foreign firms marketing commodities through local commission agents or brokers, thereby obstructing the flow of a vital part of international trade. All three draft conventions had embodied the principle that income from sales by a foreign enterprise through a local bona fide commission agent or broker should be exempt, whereas those through a permanent establishment should be taxable. After two years of study, the Fiscal Committee adopted a definition of what constitutes a bona fide commission agent or broker as distinguished from a permanent establishment, which represented the consensus of the leading tax administrations and has been very helpful in clearing up this delicate point. To those versed in the problems of taxation of interstate business, it bears a broad resemblance to the concept of what constitutes not doing business as contrasted with doing business under the laws of the various states of the American Union.

Perhaps the most important work undertaken by the Fiscal Committee, however, was the study of the various methods of determining income attributable to permanent

establishments in each of two or more countries in which an enterprise may operate. The draft conventions provided that where an enterprise has permanent establishments in two contracting States, their competent administrations should come to an agreement as to the basis for an apportionment. The Committee felt that more definite criteria were needed.

With the aid of funds provided by the Rockefeller Foundation, the Committee undertook to examine the basic principles of taxation and the methods of allocation in 35 countries. To supervise the work, a special sub-committee was appointed, which designated me to conduct the survey and sent me to the majority of the countries in question to assist in the preparation of reports, most of which were published by the League in the five-volume work entitled *Taxation of Foreign and National Enterprises.* The main objective was to find principles and methods that would be generally acceptable in dividing income between countries in which goods were wholly or partially produced, processed, or manufactured, and those in which they were sold. In other words, if goods were manufactured in one country and sold in a second, how much of the profit was to be allocated to the factory and how much to the sales branch? To take a more complicated example, if raw materials were produced in one country, processed in a second, utilized in manufacture in a third, and if the final product was sold in a fourth, how much of the profit arising on sale should be taxable in each jurisdiction?

The survey therefore included countries with practically all kinds of tax systems and at all stages of economic development, such as, on the one hand, the highly industrialized countries of Europe, and, on the other, those producing chiefly raw materials, such as British India, Netherlands

India, Cuba, and Mexico. It also included countries advanced in both industry and agriculture, such as the United States, Canada, and Japan.

The results of the survey were digested in Volume IV of the above-mentioned publication and, on the basis thereof, a draft multilateral convention was formulated in 1933 and submitted to the various countries. In 1935 it was slightly revised.[12] Although no multilateral convention has yet been negotiated on the basis thereof, its contents have been reflected in several bilateral agreements.

It was found that, broadly speaking, there were two conflicting approaches to the determination of the profits of a permanent establishment. According to one method, profits should be determined separately on the basis of the accounts of the establishment. The other method was to attribute to the local establishment a part of the entire net income of the enterprise, which was reflected in the accounts of the head office abroad. The former method was termed "separate accounting" and the latter "fractional apportionment." The majority of the committee felt that it would be unwise and impractical to permit each of the several countries in which an enterprise operates to require the submission of its head office accounts so that each administration could determine its share thereof. The claims would probably overlap and result in double taxation. The differences in language, currency, and accounting methods would result in an intolerable burden upon the enterprise. Moreover, the preponderant opinion in governmental and business circles had been found to be that each permanent establishment of a foreign enterprise should be treated as an independent entity dealing at arm's length with the other establishments.

The Fiscal Committee therefore adopted as the basic pro-

[12] League of Nations Document C.252. M.124.1935.II.A.

vision of the convention that each State should tax an enterprise of another contracting State only on the profit allocable to a permanent establishment within its territory.

The profit allocable to a local permanent establishment is the net business income which it would be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions (Article III). Such net income should, in principle, be determined on the basis of the separate accounts pertaining to such establishment. The fiscal authorities are authorized to correct errors or omissions in such accounts or to re-establish the prices or remunerations entered in the books at the value which would prevail between independent persons dealing at arm's length.

If such procedure is insufficient, the fiscal authorities may resort to a method employed in numerous States for determining empirically business income of local branches of foreign enterprises or even domestic enterprises, namely, that of applying to the turnover of the establishment a percentage which is fixed in accordance with the nature of the transactions of the establishment and by comparison with the results obtained by similar enterprises operating in the country. This flexible formula is necessary because the rate of net income to gross receipts for a branch marketing one type of goods is likely to be quite different from that selling another type.

Where the nature of the activities of the branch is such that it is impossible to maintain an accounting which would reflect its income separately and where the percentage-or-turnover method is not feasible, as a last resort the authorities may employ the method of fractional apportionment of the net income of the enterprise derived from activities in which the establishment has participated. This deter-

mination is made by dividing such net income in accordance with the ratio of appropriate factors similar to those employed in the formulas for fractional apportionment under several state income tax laws of this country. The convention imposes the limitation, however, that the result shall approach as closely as possible that which would be reflected by separate accounting.

The Fiscal Committee also elaborated proposals for the prevention of double taxation of patent and copyright royalties, which stated, in principle, that they should be taxable only at the fiscal domicile of the licensor, and formulated general plurilateral conventions embodying subjects on which there was relative unanimity of opinion.

The Revised Mexico City Draft

At the instance of the delegate from Mexico, the Assembly of the League, on September 29, 1938, asked the Secretariat to study and advise upon the principles on which fiscal legislation dealing with the main categories of taxes, such as income tax, land taxes, and turnover taxes, should be based, and this subject was referred to the Fiscal Committee. Preliminary studies were made, and a report was prepared which was submitted to a regional meeting held in Mexico City from June 3 to 15, 1940. At the same time, there was submitted to that meeting a draft convention that might be used as a guide in the negotiation of treaties between countries of this hemisphere. A study of the sixty-odd bilateral conventions which, during the past twenty years, had been concluded between various European States, as well as those entered into by the United States with France and Sweden, revealed a prevailing trend towards the form of convention 1(c), adopted in 1928. Therefore, the new draft followed its form and embodied many of the most recent treaty pro-

visions, as well as the proposals of the Fiscal Committee concerning the definition of a permanent establishment, the allocation of income, and the treatment of royalties.

The Mexico City meeting included high officials or experts from Argentina, Brazil, Mexico, Peru, and Venezuela, as well as Canada and the United States. Hence, members of tax administrations of these countries have together revised and adopted a model which could be followed by their governments in concluding conventions to remove barriers to commercial intercourse and contribute to greater economic solidarity.

Summary of General Conventions

The utility of double taxation conventions in removing economic barriers is evidenced by their widespread adoption in Europe.[13] Even in 1921, when the League was beginning its studies of the prevention of double taxation, Germany began to remove tax barriers to trade with new countries resulting from the peace treaties, such as the Saar and Czechoslovakia, and in the years immediately following, with Austria, Hungary, the U. S. S. R., and Italy. In 1922, Italy invited the Succession States of the Austro-Hungarian Empire to come to Rome and negotiate a multilateral convention, which, however, came into effect only as between Austria and herself. It is significant that the Italian Director General of Taxes, Pasquale da Roma, was the president of the committee of technical experts appointed by the League in 1922, and that he immediately proceeded to combine theoretical discussion with practice by negotiating treaties with his neighbors.

[13] League of Nations, *Double Taxation and Fiscal Evasion: Collection of International Agreements and Internal Legal Provisions for the Prevention of Double Taxation and Fiscal Evasion.*

By the time the general meeting of government experts met in Geneva in 1928, most of the countries of Central Europe were parties to one or more agreements. After that meeting, Germany and Italy continued to negotiate treaties, and France began to take a leading part by concluding agreements with Italy, Belgium, the United States, Germany, Sweden, and Switzerland. By 1939, practically all the European States were signatories of one or more of the network of bilateral conventions which contained essentially the same principles endorsed or advocated by the League committees. A notable exception was the United Kingdom-Irish Free State agreement which provided for the reciprocal exemption of all classes of income at source and their taxation only at the residence of the recipient. Apart from the last-mentioned, the general effect was that of a multilateral treaty, with minor exceptions necessitated by the peculiarities of the different tax laws.

Many of these agreements were brought about by conversations between committee sessions on the shores of Lake Geneva, and more than fifteen were concluded during the depths of the world economic depression, from 1930 to 1935. Apart from the sixty-odd general conventions, there are about seventy providing the reciprocal exemption of shipping profits, five for the similar treatment of air navigation, twenty exempting foreign enterprises on income from sales through certain types of agents, and numerous others on death duties and miscellaneous subjects, making more than three hundred altogether.

The first treaty to which the United States was a party was that with France, which was signed in 1932 and came into effect on January 1, 1936. Its primary purpose was to prevent the extraterritorial imposition of the French dividend tax on American corporations with branches and sub-

sidiaries in France. A tax treaty between this country and Sweden was negotiated, which came into effect on January 1, 1940. A second treaty with France was approved for ratification by the French Government in August, 1939, but it has not yet been ratified by the United States. Negotiations have taken place with Canada and the Netherlands and were contemplated with other European countries when the war started.

Basis for Inter-American Treaties

With the background of experience in Europe and with the formulation of the Mexico City draft convention, the foundation has been laid for the negotiation of an inter-American network of treaties to remove unnecessary barriers to trade.

Thus, barriers to the flow of commodities can be lifted by provisions for the reciprocal exemption from tax of sales through commission agents or brokers.

Barriers to the sale of merchandise can be removed by exempting sales effected through traveling salesmen, and by exempting the salesmen themselves from income taxation if they are in the country for less than 180 days in the aggregate during the taxable year, as the treaty with Sweden provides.

Barriers to the opening of commercial establishments can be reduced by the adoption of fair principles and methods of allocation of taxable profits.

The flow of capital to underdeveloped countries can be encouraged by the reduction or removal of source taxes on dividends and interest which, in effect, constitute a tariff on capital. This was shown when Germany and Italy removed such obstructions to the inflow of foreign capital during the 1920's.

Finally, if income is to be taxed both in the country where it arises and again in the country of the recipient, the latter should grant relief from its tax similar to the credit for foreign taxes in section 131 of the Internal Revenue Code.

All the foregoing and other sound measures, including one to prevent discriminatory taxation, are embodied in the Mexico City draft. If our good neighbors would conclude treaties of this nature between themselves and with us, inter-American business would be greatly encouraged to expand.

CHAPTER XXI

TAX CONVENTIONS OF THE UNITED STATES

Eldon P. King

Special Deputy Commissioner, United States Bureau of Internal Revenue

Prior to the outbreak of the present war, all indications were that the year 1940 would be an active tax convention or treaty year. Countries abroad were coming rapidly to use this method of approach in the interests of international trade and for the solution of tax problems, and the United States had renewed its activities in this field. The world interest in the subject is indicated by the fact that about sixty general agreements were concluded between the termination of the World War and 1940 and, counting the special agreements relating to some particular phase of taxation, such as shipping, aircraft, or agencies, the number of agreements exceeds three hundred. This is in contrast with only about twenty agreements concluded before 1919. In addition to concluding several agreements in recent years, the United States had entered into active negotiations with certain countries and discussions with other countries, which were suspended upon those countries becoming involved in the conflict.

Notwithstanding the recent turn of events, it is believed that the future holds considerable hope for renewal of tax convention activities on a broad scale upon restoration of peace conditions. Pending such development, however, certain Latin American Republics have evidenced a growing interest in cooperative methods looking to the solution of

international taxation problems, and within the current year several of these countries have made studies of our tax methods and tax conventions. Nothwithstanding that the subject is a technical one and the progress at times slow, this recent background, together with our growing commercial relations with these countries, may ripen into tax convention negotiations. When it is considered that a major incentive for the rapid growth of tax conventions following the last war was the high national debts and accompanying high tax rates, it would seem that the incentive is likely to be much stronger upon the termination of the present war. Moreover, having in mind that another important objective of conventions is to promote the flow of capital, trade, and commerce, there is additional indication that eventually the interest of the war-torn countries in conventions will multiply.

Upon examining the program of this meeting, where no barrier to trade seems to have been overlooked, it seems appropriate to make at least some reference to our several tax conventions, since each has some relation to the general subject. It seems most convenient, however, to refer first to our latest convention, which is the most closely related to the subject. I refer to our agreement with Sweden, which became effective January 1, 1940, and which is the most comprehensive of our agreements. Other conventions which I will subsequently touch upon are those with France and with Canada, both of which became effective January 1, 1936, and some reference will be made to a group of about twenty-five bilateral agreements which deal with the taxation of profits derived from the operation of ships.

There are few income taxation measures that are not of a technical nature, and the typical income tax convention is far from being an exception to the rule. I shall attempt,

however, a nontechnical approach to a technical subject and give particular reference to its effect on international business operations.

United States—Sweden Convention

A common relationship in international business is that of the business enterprise (individual, partnership, or corporate) in one country to its permanent establishment (branch, office, agency, and the like) situated in the other country. Major problems affecting the business income arising from this relationship are those with respect to (1) the policy of each country in apportioning business profits between the enterprise and the permanent establishment, (2) the policy of the home country of the enterprise in taxing profits of the permanent establishment which have been taxed in the other country, and (3) the policy of the country where the permanent establishment is situated in looking to the profits of the enterprise in the home country as a basis for taxation.

The policy of apportionment is particularly troublesome. The methods of apportionment are practically unlimited and in the absence of a convention it frequently happens that the unilateral methods employed by two countries will result in the tax being laid on more than 100 per cent of the profits of the international business. As a solution to that problem, under the United States-Sweden convention it is specifically provided that the competent authorities of the respective countries may lay down rules by agreement for the apportionment of industrial and commercial profits. Express authority is also granted the taxpayer to appeal to his country when he believes that the action of the revenue authorities of the countries has resulted in double taxation. The forum provided thus insures as nearly as may be that

no more than the actual profits will be subject to tax. Conversely, it tends to discourage tax avoidance.

Of material concern to the enterprise is the attitude of its own country in taxing the profits of the permanent establishment which have been taxed in the other country. The United States has long since approached this problem through the somewhat indirect method of first including the foreign income with the domestic income and then crediting the total tax with the foreign tax paid. There are certain limitations, however, which may or may not give full benefit of the foreign tax paid, depending on a variety of circumstances. The Swedish approach, like that of many foreign countries, is more direct. Sweden grants complete exemption from its normal or flat rates of the income taxed abroad, and since only a flat rate is imposed on a Swedish corporation, the income of a foreign permanent establishment of such a corporation is exempt from Swedish tax. These existing methods of the two countries are retained and made a part of the convention. In addition, however, Sweden, in contravention of its laws, agreed to convention provisions designed to give credit for the United States tax against its graduated tax upon income which has been taxed in the United States, except dividends which are dealt with separately and given a credit on a different basis. The credit granted on the items other than dividends conforms substantially to the foreign tax credit principles employed by the United States.

The foregoing provisions should be considered in connection with preceding provisions relating to busines income. Reading the two together, the net result is that the two countries undertake not to tax the international business on more than 100 per cent of its profits and, after making proper allocations, to eliminate or reduce substantially

double taxation on the profits so allocated. Both plans represent substantial contributions to the elimination of double taxation. It is perhaps well also to emphasize at this point that unilateral legislative methods employed for the elimination of double taxation and the tax convention methods are not mutually exclusive but are frequently coordinated, as has been indicated.

The third point concerning the enterprise-permanent establishment relationship involves the attitude of the country in which the permanent establishment is situated in looking through the establishment in an effort to make the enterprise an object of taxation. It not infrequently happens that methods often arbitrary in character are employed in the imposition of extraterritorial taxation. But, out of fairness to at least certain of the countries employing them, it should be mentioned that the motive can often be traced to a discovery that the permanent establishment of a foreign enterprise has been operating over a long period under bookkeeping methods which show no profits. It is difficult for revenue authorities in almost any country to understand why a business would remain in that country for reasons of health or to enjoy the scenery. The principle is taken care of through the convention with Sweden by a provision that there will be taxed only the income allocable to the permanent establishment; thus there is removed the possibility of extraterritorial taxation as between the United States and Sweden. The agreement in this respect was facilitated through the provisions for close cooperation previously discussed and other administrative provisions which will be subsequently discussed.

Another common international business relationship is that of a corporation of one of the contracting countries maintaining a controlled or subsidiary corporation in the

other country. This subject is dealt with in Article III, the enterprise-permament establishment relationship previously mentioned being covered in Article II. Provision is made through Article III whereby either country may, when necessary, and subject to applicable measures of appeal, place the commercial or financial accounts on an independent contract basis. Articles II and III thus contemplate that there shall be a complete power of adjustment in matters of business income similar to the principle employed for domestic purposes in section 45, Internal Revenue Code.

The United States-Sweden convention is not confined to the field of what is technically designated as industrial and commercial profits or business income, discussed in the foregoing paragraphs, but is designed to cover the entire field of taxation existing between the two countries and carries administrative cooperation provisions necessary to its enforcement. Thus, Articles V to XIII, inclusive, are devoted to many specific items other than industrial and commercial profits. Through these articles there are considered and disposed of income derived from real property, including rentals and royalties therefrom, income from the use of patents, secret processes and formulae, trade marks and other analogous rights, dividends, interest, gains from the sale of capital assets, salaries and pensions paid by the countries, private pensions, life annuities, compensation for labor and personal service, including practice of the liberal professions, and remittances received by students and business apprentices.

The plan adopted for taxing the items of nonbusiness income enumerated is, in general, to assign the income to one country or the other but not to both. For example, income from real property is allocated to the country where

such property is situated, and salaries, compensation, and pensions paid by one of the countries to individuals residing in the other are allocated to the paying country. But with respect to other items, such as royalties from patents, trademarks, and private pensions, the country of residence rather than source does the taxing, with certain minor exceptions. With respect to dividends and interest, each state reserves certain rights to tax but provides for the elimination or alleviation of double taxation through the tax credit provisions.

The net result of the foregoing provisions with respect to nonbusiness income is that, through allocation of income as between source or residence or through the operation of the respective national tax credit systems or the special credit systems provided for in the convention and made applicable to Sweden, double taxation is either eliminated or very substantially reduced. However, the credit system adopted by Sweden through the provisions of the convention operates in the following two respects which seem worthy of special note. Through the provisions of Article VII, Sweden reduces its tax on dividends from Swedish sources to 10 per cent in order to meet the 10 per cent rate collected by the United States at the source. The normal aggregate rate for such Swedish taxes in the case of individual shareholders is approximately 15 per cent and in the case of corporate shareholders approximately 20 per cent. Considering that business of United States corporations in Sweden is normally done through Swedish subsidiary corporations, the class of United States taxpayers affected by Articles III and VII derives considerable benefit. Again, through the provisions of Article XIV (b)(2), Sweden provides for a credit to a resident of Sweden of 5 per cent of the amount of dividends received from United States corporations, this

percentage being about the average tax paid in Sweden on dividends received from abroad.

The following provisions also either eliminate or reduce double taxation: Purchases of merchandise in one country by an enterprise of the other country are not subject to tax in the former country (Article II); An enterprise of one country merely having business dealings in the other country through a bona fide commission agent, broker, or custodian is not subject to tax on income from such dealings in the latter country (Par. 1 [a] Protocol); Taxation of income from maritime and aerial navigation is, with minor exceptions, left to the country of domicile rather than source (Article IV); Concessions are made with respect to certain classes of income derived through personal service (Article XI) and with respect to remittances received by students and business apprentices (Article XII).

Articles XV to XIX, inclusive, are devoted to the interesting subject of administrative cooperation between the two countries as affecting both assessment and collection. Provision is made in Article XVI for the automatic exchange of information in certain instances, particularly as affecting items of fixed and recurring income such as dividends, interest, royalties and pensions, and in Article XVIII for particulars in specific cases. Article XVII pertains to cooperation in certain matters of collection and provides, in effect, that one country may request the other to conserve the property pending determination of the tax and, should the tax be determined favorably to the applying country, to collect and pay it over to that country. The articles are framed on a reciprocal basis and contain certain reservations pertaining to national sovereignty.

The administrative provisions are devoted to the double aspect of preventing extraterritorial and double taxation

and giving assurance that the revenue will be properly protected. For example, the countries having agreed to avoid extraterritorial taxation by confining taxation of business income to the permanent establishment and to avoid double taxation by laying down rules for the apportionment of business profits and to rectify accounts as between the parent and the subsidiary corporation, it is but natural and proper that they should provide for reciprocal exchange of information in a field that is primarily factual. Conversely, agreements devoted strictly to extraterritorial and double taxation provisions are likely to prove unsatisfactory in their administration and result in inequitable and perhaps retaliatory methods.

Where tax conventions provide for taxation of income at residence of the recipient and exemption at source of the income, it is usually important to furnish the country of residence information relating to income from the country of source; otherwise, in the process of eliminating double taxation the income may completely escape tax. The administrative provisions conform to the long-standing investigative and information provisions of our own tax structure and guard against the anomaly of opening tax loopholes in the face of efforts over a long period of years to close them. In general, such provisions have the effect of placing safeguards around the international system which most countries insist upon with respect to their domestic system.

United States-France Convention

The tax convention between the United States and France, although of considerably less scope than the convention between this country and Sweden, nevertheless contains important provisions and can be regarded as a land-

mark in the sense that it represents our entrance into the tax convention field. This convention did not become effective until January 1, 1936, but it was negotiated in the early 1930's and is more representative of the narrower conventions of that period than of the period in which the United States-Sweden convention was negotiated. The principal points of similarity and dissimilarity between the two conventions may be summarized as follows:

The approach to the elimination of extraterritorial and double taxation in the field of business income through the enterprise-permanent establishment relationship and the parent-subsidiary relationship is much the same in the two conventions, but with the important exception that the countries are not, in the French convention, granted authority to lay down rules by agreement for the apportionment of business income. Unlike the United States-Sweden convention, the United States-France convention contains a time limitation within which American business interests in France must exercise their election to come under the convention and many, to their subsequent regret, failed to meet this requirement. There was also another limitation, which subsequently produced considerable controversy, affecting the taxable periods which could be brought under the convention. The United States-France convention deals with taxation of certain items of fixed or determinable annual or periodical income and of income from aircraft operations, but no attempt is made to cover the entire field of income taxation as is done in the United States-Sweden convention.

It is of importance to note that the United States-France convention contains no provisions authorizing administrative cooperation in matters of tax assessment and collection with respect to either business or nonbusiness income. Therefore, among other things, there could be no exchange

of information respecting business income, and certain fixed and recurring items of income could flow tax-free from the country of source to recipients in the other country without accompanying information being furnished to the latter country.

Although the United States-France convention was found to have many shortcomings from the point of view of both governments, and a new convention of broad scope was negotiated in 1939, it nevertheless brought the two countries closer together and, within its limitations, afforded solution of certain general issues and controversies in particular cases. The new convention, however, has not been consummated, because of political changes effected through military operations in Europe. By its terms the existing convention with France will continue in effect until January 1, 1941, and thereafter until twelve months from the date on which either country gives notice of termination.

United States-Canada Convention

The United States-Canada convention was brought about through express authority granted by Congress in sections 211(a) and 231(a) of the Revenue Act of 1936 to reduce by convention certain tax rates with respect to certain individuals resident in a contiguous country and certain corporations organized under the laws of that country. Pursuant to this authority a convention was subsequently concluded and became effective as of January 1, 1936. It is believed that this convention holds the greater interest for present purposes, because of certain of its administrative provisions.

Since Congress desired to extend only limited benefits to certain classes of Canadian individuals and corporations, and since the withholding provisions of sections 143 and

144 of the Revenue Act of 1936 were made applicable, major administrative difficulties and possible disturbances of commercial practices would have been encountered in carrying out the Congressional intent, had the tax convention method not been available. For example, it was known that substantial amounts of income would pass to record owners in Canada, merely as conduits to the actual owners, who were not entitled to the lower rate granted by Congress.

It was desired to place a minimum strain on our standard commercial practices in the movable capital field, on our numerous domestic withholding agents, and on the administrative machinery of the Bureau of Internal Revenue. After joint conferences between representatives of the two countries and the business interests concerned within the respective countries, this was accomplished, in substance, by the United States authorities furnishing the Canadian authorities information with respect to income going into Canada, and by that country installing a system necessary to trace the income and to provide for payments into the United States Treasury of additional tax from taxpayers not entitled to the lower rate. Such payments have since been made regularly and in substantial amounts.

The system placed a minimum burden on the United States withholding agents by requiring that they look only to the Canadian address for withholding purposes and left undisturbed business practices concerning record ownership of securities. The administrative measures agreed upon brought the convention immediately into operation and relieved Canadian beneficiaries and the United States tax bureau of heavy burdens incident to tax refunds had the maximum tax rate, rather than the reduced rate, been withheld at the source in the first instance. The administration of the convention is illustrative of the desirable re-

sults which can be accomplished through cooperation in the international field of taxation.

Reciprocal Agreements on Shipping

Although not strictly within the tax convention field, our reciprocal agreements with other countries pertaining to profits derived from maritime navigation are closely related to this subject and seem to deserve some special mention. Through section 213(b)(8), Revenue Act of 1921, Congress granted authority to exempt from tax certain income of nonresident aliens and foreign corporations derived from the operation of ships documented under the laws of a foreign country which grants an equivalent exemption to citizens of the United States and to corporations organized in the United States, and the same principle has been carried in subsequent legislation. Altogether, the United States has concluded about twenty-five bilateral agreements with other countries.

The reciprocal agreements on shipping, in effect, waive the source system in favor of the domicile system of taxation. In addition to encouraging international shipping, the agreements remove difficult tax administrative burdens incident to determining the amount of income allocable to a foreign ship within the domestic port, which accounts in no small degree for the popularity of these agreements.

At one time it was proposed to extend on a reciprocal basis the principle of the arrangements on shipping to practically all of the problems existing in the international field, including the various business relationships, the specific items of fixed or periodical income, and problems of residence and domicile. The plan is set forth in detail in H. R. 10165, a bill designated as the "International Double Taxation Relief Act of 1930." The bill was subject to severe

criticism because of the many loopholes which it opened (Hearings before the Committee on Ways and Means, International Double Taxation, February 28 and March 1, 1930). With respect to the matter of shipping profits, however, on which taxation is imposed only at domicile, the operations beyond the country of domicile are of such a character as to make evasion unlikely, and hence the problem is not of great importance. H. R. 10165 is illustrative of the attempt over a long period to find ways to solve the international double taxation problem and forms an interesting contrast to the approach through the broad convention method.

Earlier in this discussion I referred to the high national debts and budgetary exigencies following the last world war as producing problems which called for careful attention if international business was to survive and progress. Solution of the problems logically devolved upon the League of Nations, which assumed the burden and has assiduously applied itself to it up to the present time. During the past decade the work has been carried on primarily through the Fiscal Committee, which succeeded a subcommittee having similar functions. These committees, acting in an expert and advisory capacity to the League Secretariat, circularized countries for their views, drew up model tax conventions as an available guide and, what is of particular importance, afforded a forum where representatives of countries interested in international double taxation could meet, exchange views, and judge the possibility of solving the problems through tax conventions or other methods. For example, 27 nations were represented at the conference held at Geneva in 1928, when the framing of model conventions was under active consideration. The United States Treasury Department was represented at certain of the meetings during the

late 1920's, including the meeting at Geneva in 1928, and after informal contacts was again represented in 1936, 1937, and 1940.

At this point I desire to pause to pay tribute to the outstanding aid and assistance afforded to many countries by the Fiscal Committee of the League of Nations and its related and predecessor committees in their efforts to solve international tax problems.

In conclusion, I think it appropriate to state we have found that the tax convention method, while not solving all the problems in this complicated field, represents an important step in the right direction. Even the limited convention has been found desirable within its scope, and the broad type convention has been found particularly desirable. The latter type has the merit of setting forth in one instrument the taxation policies of the contracting countries and giving the taxpayers and governments concerned a certainty and clarity substantially the same as that present in the domestic systems of the two countries. While our policy with respect to adoption of tax conventions of comprehensive scope appears to have met with approval in both official and business circles, it is appreciated that solution of international tax problems has not reached the point of perfection. Any criticism, therefore, will be welcomed and carefully considered in the future development of that policy.

CHAPTER XXII

INTER-AMERICAN FISCAL RELATIONS

CHARLES R. CARROLL

Counsel, General Motors Overseas Operations; and Chairman, Tax Committee, National Foreign Trade Council

"TAX barriers to international trade" is a topic that has become unpleasantly familiar to those of us who have to deal with foreign trade. All of us see pictures of the physical mechanism of war at work—the better publicized mechanism of plane and tank, surface and undersea raiders; the drama of invasion on land, blockade by sea; the clash of arms in which even the law is silent. In the areas affected we have little of the ordinary intercourse which we call trade—and even that little must be carried on over or through barriers created by, or blamed upon, the war. Nations with which we are at peace, and which are not at war with anyone, cannot now deal with us—lest those dealings give aid or comfort to someone's enemies.

Even outside of the combat area, we see the play of the weapons of economic warfare—the long range blockade, implemented by the navicert system; exchange controls; import licensing; clearing agreements; shipping commandeered or laid up to escape the threat; and last, but no longer negligible, our own government's increasing control over export trade and its financial phases.

With all these in near perspective, it is difficult to turn our attention to those barriers which, even in times of peace, stand between us and the market places of the world. It

will be easier if we frankly say that while England and Germany are at war, we need not look for either of them to lay aside any weapon or remove any barrier which they find useful. Our Congress has required of us that we stay outside the reach of the weapons. Our State Department will not insist on the barriers being removed.

If we look elsewhere than Europe, we find the reflection of the war in many ways in many places. Most of all, we find peoples and politicians arguing for self-sufficiency—autarchy. In this world of power politics, it has its attractions, surely. To be realistic, we should be safest in developing only that trade, and encouraging only those investments, which conform to the geography of our military, air, and naval capacity, actual or projected. Obviously, this "regional" concept suggests intensification of our efforts toward cultural and economic understanding with our American neighbors.

There are barriers to trade between the Americas. It is natural to think first of customs barriers and as to these as barriers we need say little here except that for every barrier our potential customers have raised, we have probably raised one equally high. We have not generally been as good customers of theirs as they have of ours. Whether this situation will improve substantially in the near future is not a matter for generalization. It is improving in the case of certain South American countries, whose economies are naturally supplementary to our own. As to those whose economies are parallel to our own, or nearly so, we should not put too much faith in artificial stimulants. It is not real friendship to encourage resort to such stimulants, unless we also will assume some responsibility for the morning after. Which may suggest a distinction between loans and investments.

This brings me to a pet thesis. Customs duties are bar-

riers or controls on the movement of physical goods. Taxes function, in part, as barriers or controls on the movement of capital funds, and, to a certain extent, operate similarly on industrial property. The principal difference is that customs duties are more generally levied for their economic effect, while taxes (with some notable exceptions in recent years) have generally been resorted to for revenue. The interesting thing about our Latin American neighbors is that, until quite recently, taxes have not been of such an order arithmetically as to act as a deterrent to the influx of needed capital. In fact, the tax burden presently borne by capital in most of these countries is not so high as to be comparable to the more attractive returns on investment there, as compared with other areas of the world.

We should not be misled, however, into thinking of their tax systems in terms of our own. The pattern is usually one related to the Continental, that is, a fair variety of taxes, such as excise, license, turnover, sales, and stamp taxes, with much less reliance on income and profits levies than in our own country. Such a pattern has its attraction in increased stability of revenues, but, more than that, it seems to be characteristic of less highly industrialized countries; whereas with industrialization, the income and profits tax seems to take on more importance. Apparently, these other taxes, which are largely resorted to, fall particularly upon the commercial classes, as distinguished from the industrial enterprises. The turnover or transaction tax, and the *patente* or license tax, however, are frequently collected alike from merchants and producers.

When we study the revenue patterns of our Latin American neighbors, the first thing that strikes us is the relatively small part that income and profits taxes have played in the past; the second is the increasing part they are playing,

especially in those countries where industrialization is going forward, and, in a far greater measure, a decrease in the proportion of customs revenues to total revenues, though not necessarily any decrease in the absolute volume of customs revenues.

For example, in Argentina, customs duties ranged between 53 and 65 per cent of the national revenue in the period from 1903 to 1929. In the period of the acute depression, we find a rapid drop from 60.5 per cent in 1928 to 39 per cent in 1932, and since that time a range of around 40 per cent of total revenues has been obtained from customs. Argentina resorted to a profits tax in 1932, realizing in that year 7.2 per cent of its national revenue from that source, and showing fairly consistent increase, both relatively and absolutely, to 11.5 per cent in 1938, the last year for which analyses are available.

Figures from Brazil are rather erratic as regards customs duties, which still, as of 1937, produced 41 per cent of the national revenue, approximately the same as in 1927. But they show a familiar pattern as to income taxes, which yielded a modest 4 per cent in 1927, but rose to 16.3 per cent in 1936 and a respectable 21.3 per cent in 1937.

In Chile, we have a rather unsatisfactory statistical picture, in that a substantial part of the national revenues is derived from so-called export duties on nitrate and copper, and these have been lumped with import duties. As of 1937, these two sources of revenue, taken together, produced 47.9 per cent of the national revenue, within 1 per cent of the amount in 1907, although in intervening years a drop to less than 30 per cent occurred. This was not a drop in absolute yield, but reflects the addition of revenue from income and profits taxes, which in 1908 yielded 18 per cent of the national revenue. We have no recent figures on

income tax yield in Chile, but in 1934 this tax produced only 12.7 per cent of the national revenue, which was abnormally low that year.

In Peru, we have the familiar picture: Customs duties in 1912 produced 37.8 per cent of the modest national revenues, and in 1917 about the same proportion of a tripled amount. In recent years the yield, though increasing absolutely, has stabilized relatively at about 26 per cent of the total revenues. The yield from profits taxes has risen fairly steadily, both absolutely and relatively. In 1931, this impost produced 13.5 per cent of the revenue, and in 1937 this had risen to 22.8 per cent.

In Mexico, again, customs duties produced about 40 per cent of the national revenue in the years prior to 1914. In the last few years they produced only between 20 and 23 per cent, despite an increase in the absolute yield. Income and profits taxes, to which Mexico resorted in 1925, produced about 5 per cent of the revenue from 1928 to 1933, then jumped to 8.9 per cent in 1934, and rose to 11.2 per cent in 1937.

As most of the available figures are necessarily in local currencies, which have fluctuated widely, I have avoided comparison of the total revenues in different periods.

In these figures I have not tried to identify the various categories of taxes, other than income and profits taxes, to which most Latin American countries have resorted for not less than half their revenue in recent years. I merely call your attention to the broad fact that the major part of the contributions which capital and enterprise make to the expense of government in our sister republics is not in the form of income or profits taxes but rather in what Washington calls "miscellaneous taxes." In my opinion, this revenue pattern will change in the direction of increased re-

liance upon income and profits taxes, but only in the degree to which industrialization of each country extends, and only at the speed with which that industrialization takes place. In fact, there would seem to be an appreciable lag in some instances. When we realize that almost one-half of Argentina's employed in 1938 were classified as industrial, it is obvious that this substantial degree of industrialization is not yet reflected in the fiscal system of that country.

I have two purposes in these remarks. The first is to second most heartily the claims upon your interest and support for a program of tax treaties between the governments of Latin America and our own, so that the inherent hazards of tax incidence and the difficulties of tax administration will not be aggravated by the additional problems of income allocation and the danger of duplicate taxation. The trend in Latin America evidently is toward increasing tax burdens upon industry and capital, both absolutely and relatively. It should be easier to negotiate and conclude sound and more or less permanent treaty arrangements at this juncture than later.

My second point is one on which I do not expect unanimous support, but one on which I believe free discussion at this time would be particularly opportune. I suggest, in short, a re-examination of a legislative policy which was adopted in 1918 and has since become almost a tradition. I refer to the system of avoiding double taxation by granting credit for foreign taxes paid on income from foreign sources. Bearing in mind that this system is a unilateral legislative act, not wholly reciprocal in operation, it still operates as it was intended, as an inducement to American enterprises to establish themselves abroad. Its vice is that the system is subject to outright repeal or legislative attack at any time. It is not always realized that there are two

alternative methods of eliminating double taxation. One is by the credit method referred to. The other is by outright exemption from taxation of income earned abroad. The Spanish tax law does just that: it excludes from taxable income, income earned abroad, and it exempts from dividend taxes a corresponding proportion of the corporate distributions.

When the different patterns of Latin American taxation are considered and the fact that our credit is only for "income and profits taxes," it will be seen that an American enterprise cannot recoup by way of these credits the entire contribution it will have made to the local revenues. For example, license and turnover taxes, and property taxes on capital, are not available as credits, but may represent a large part of the tax burden which an Argentine establishment will have borne. If the intent is to relieve the double imposition, only outright exemption of income from foreign sources really meets the test.

Of course, there might be administrative difficulties in allowing such an exemption of foreign income. But I do not think anyone who has had much experience in the preparation, audit, or settlement of a claim for credit for foreign taxes would hesitate a moment to recommend outright exemption on the ground of simplification, if no other.

Whether or not such matters can best be dealt with by general tax legislation, unilaterally, or whether, on the other hand, appropriate stipulations should be written into tax treaties is a matter of individual preference. My own preference is for the treaty method. I prefer it because almost anything that works in the direction of certainty and stability is of distinct advantage to the business community. While we have not had many tax treaties, they have endured.

On the other hand, tax legislation has been frequent and has involved substantial changes in the form and incidence of the tax burden upon business, as well as in statutory and effective rates. Even the foreign tax credit provisions have not been immune but have suffered encroachments without precise motive.

Speaking for business, a system of outright exemption of income from foreign sources, incorporated in treaties, would be most desirable, because of its simplicity and relative permanency. Speaking as a student of tax problems, I believe that a system of treaties, with generous reciprocal exemptions, implemented by sound definitions and methods of allocation, is not only feasible but quite opportune. And I would humbly suggest that, from the viewpoint of the tax administrator, it would represent a substantial advance in simplicity and certainty without any appreciable prejudice to the revenues.

From whichever of these angles we approach the subject, we may be assured that here is an area in which even a moderate amount of interest and support promises results of definite importance. Intelligent and wholehearted effort of the character you have had summarized in the other papers presented at this session will surely succeed in removing some of the uncertainties and duplications in taxation which are actual or potential barriers to international enterprise.

CHAPTER XXIII

TAX BARRIERS TO INTERNATIONAL TRADE

Henry B. Fernald

Certified Public Accountant, New York City; and Chairman, Committee on International Double Taxation, American Section, International Chamber of Commerce

In paying tribute to the great work which has been done by the Fiscal Committee of the League of Nations, I want to point out that much of its accomplishment has come because it was possible to sit down and discuss frankly and calmly, with mutual esteem and respect, the problems involved and the possible remedies. The Fiscal Committee of the League, consisting largely of experienced tax administrators of various nations, has been ready and eager to discuss and consider, not merely among themselves but also with business representatives, the problems and difficulties presented. Even though our Committee of the International Chamber of Commerce has in some particulars differed somewhat from the Fiscal Committee of the League and has made recommendations for some changes in the draft treaties proposed by the Fiscal Committee, this has always been without any feeling of distrust and acrimony on either side, and we have always been able to discuss, one with another, any difference in point of view we have had. It is my earnest hope that even through these troublous times the work of the Fiscal Committee of the League may be kept alive and go forward.

We owe much to those who started the movement for elimination or limitation of international double taxation

at a time when it seemed little more than a visionary project. Their efforts in study, analysis, conference, and persistent endeavor brought it to an accepted reality. Those, like myself, who have later participated in the movement have had the easier job of trying to refine and improve and get a broader acceptance for what had already been demonstrated to be sound and practical. In much of the world we have seen treaties overthrown in the crash of international relationships, with all normal trade and trade agreements swept aside. I am glad that before this happened we had been able to see a multitude of treaties regarding international taxation in force, working satisfactorily to the benefit of the governments concerned and of the taxpayers, so we may hope that, when the dark days of the war are past and international treaties can again be resumed between those countries now at war, treaties regarding taxation shall be a recognized part of the international relationships.

At this time I am particularly desirous to see our own country expand as rapidly as possible its tax treaties with other nations. While the United States has quite definitely recognized in its internal law the desirability of avoiding international double taxation, it has been relatively slow to enter into treaties with other countries on this subject. We have made a beginning which today I am more anxious than ever to see carried forward. This is one of the ways in which we can keep burning the torch of international relationships and friendly intercourse.

I hope we will stand ready at any time to join with any other country in such treaties regarding international taxation as those negotiated with Sweden and France. Perhaps those treaties may be subject to improvement, but I would rather see a large number of treaties promptly entered into along those same lines than to have difficulties and delay

arise in trying to work out new forms of treaties. If we can have the general principles broadly recognized, as they are in those treaties, we can later more readily reach agreement as to further details.

Negotiation of such treaties should not be considered as a matter for diplomatic bargaining to see how much each country may be able to obtain from the other country as a particular benefit to it or to its citizens. We need no further inducement for such treaties than mutual agreement on fair and equitable principles. Each such agreement is another step forward in peaceful international relationships and good will. Treaties should not be reserved solely for those cases where we can obtain a special advantage for ourselves from them. Treaties should be gladly entered into whenever we can agree on the fair and equitable principles involved. The more we can have of this, the better the portent for the future. I wish we could see in the next few years every country in North and South America with reasonable and fairly uniform treaties with every other country.

This will not come all at once. We make better and surer progress if we proceed, as rapidly as possible, with one treaty after another. Also, we make better progress by being ready to adopt in each case the same, or substantially the same, kind of treaty we already have than by trying in each case to negotiate something new and different.

It is particularly desirable that there should be uniformity in the provisions which relate to allocation of business incomes as between different countries. Differences will naturally exist in specification of the particular taxes of different countries to which such treaties relate, but we should strive to avoid differences in principle of allocating income. The same standards which apply in determining whether income arises in Country A or Country B should likewise

apply in determining whether income arises in Country A or in Country C; in Country B or in Country C; in Country C or in Country D. If a corporation is engaged in business in Countries A, B, and C, its position will be much simpler if it can have the same rules to apply in determining the income which is to be allocated to each of these countries. Not merely to the taxpayers, but also to the governments concerned, much confusion and difficulty will be avoided if the rules for allocation of income between the various countries are uniform, whatever may be the particular taxes which exist in one country or another.

This matter of allocating income as subject to taxation in one country or another has nothing whatever to do with the nature or amount of the tax which each country may impose upon such income. An agreement that certain income shall be considered as derived from sources within a particular country does not in any way fix the nature or amount of tax which that country may impose upon such income, nor does it even require that that country should impose any tax upon such income. Each country is left entirely free to determine such questions for itself, subject only to such provisions for nondiscriminatory taxation as the treaties may include.

The same principle applies to other taxes, as well as to taxes on income.

A further point I should like to mention is the principle of exemption as compared with the principle of tax credit. The elimination of double taxation can be brought about under either of these methods. One principle is that a country should exempt from its taxation the income which is subject to tax in another country. The other principle is that if the same income is considered taxable in two countries, one of these countries shall allow credit against its

tax for the amount of tax imposed on such income by the other country. The principle of exemption is widely followed. For example, the Argentine exempts from its tax any income derived from sources without the country; the United States exempts from our income tax capital gains derived by nonresident aliens from sales within the United States, income of our citizens earned abroad under certain conditions; etc. Generally, however, the United States applies the principle of tax credit, by allowing to United States citizens or residents credit against the United States income tax for the amount of foreign tax on income derived from the foreign country.

The reasons for complete exemption may be varied. A country may well consider that it will benefit so greatly from having its citizens derive income from foreign sources that it can well afford to forego any tax thereon, to stimulate its citizens to engage in foreign business. Again, a country may feel, as we do with regard to the capital gains of nonresident aliens, that the imposition of a tax thereon would merely drive from this country business which, after all, it is desirable to have; and, moreover, that the difficulty of trying to collect the tax is so great as to make it not worth while to impose the tax. Undoubtedly, the elimination of income from tax is a simpler and easier method than the allowance of the credit for the amount of tax paid. So, for one reason or another, the principle of exemption from tax has been applied.

Yet, whether the principle of exemption or the principle of tax credit is applied, it does give a substantial elimination of double taxation.

In conclusion, let me say a few words as to the extent to which taxation is a barrier to international trade.

We know that any tax whatever may be to some extent

a trade barrier. We are coming to realize that in our own country many of our taxes have already passed the point of productivity. When we have real estate taxes so heavy that it is more advantageous to tear down the building than to try to operate it, we know that real estate taxes, in that case at least, have passed the point of productivity. When we have income taxes so high as not to allow a margin of net profit after taxes sufficient to justify the risks involved and the effort required, we know those taxes have passed the point of productivity. So any country in its own internal taxation may impose taxes so heavy that they become a serious barrier to trade in that country.

We are in a period when apparently we must expect that each country will impose as heavy taxes as it believes industry can stand without their having such a repressive effect as to pass the point of productivity. I think we may consider that governments generally are, in a somewhat fumbling manner, often unwisely, trying to find the maximum amount of taxes which can be raised without defeating themselves. When we see that each country intends to impose the maximum tax it can hope to collect without business repression and consequent loss of government revenues, then we know that if any enterprise has to pay twice such a tax, such a tax burden will leave no incentive for business enterprise and will prove an effective trade barrier, even if conditions are otherwise favorable for foreign trade.

The trade barriers of war and war conditions we may not be able to control, but this is only the more reason we should strive, as rapidly as we may, to eliminate any tax barriers to trade. We should do this, not merely with the thought of the present benefit it may give in each particular case, but even more with the hope of days to come of better international relationship and good will.

CHAPTER XXIV

THE WORK OF THE LEAGUE OF NATIONS ON TAX PROBLEMS

PAUL DEPERON

Secretary, Fiscal Committee, League of Nations

I APPRECIATE as a great courtesy and a valuable token of good will the invitation to speak concerning the work of the League of Nations in the field of taxation. I have, however, no mandate to speak on behalf of the League of Nations, or even of its Fiscal Committee. My remarks will merely be the views of an individual who has had an opportunity to follow for a number of years the technical work of the international bodies in Geneva.

Perhaps I should give at this juncture a general answer to questions which have been put to me, in a most friendly manner, as to what was happening to the League, and especially to its Economic and Financial Organization.

At the outset of the war, it was found of obvious interest to most governments that the activities of the technical organizations of the League should be continued as far as possible. The work of the Economic Intelligence Service, although certain annual publications had to be foregone, was becoming still more necessary, precisely on account of the very conditions created by the war. At the same time, it appeared desirable to undertake a preparatory study of the problems which would have to be answered when peace was restored.

Before the war, Switzerland was in a privileged position as regards communications. The events of last May rad-

ically changed the situation. It became necessary, especially for the sake of the economic intelligence work, that part of the Economic, Financial and Transit Department of the League Secretariat should be delegated to carry on its activities outside the zones of war. A joint offer of Princeton University, the Institute for Advanced Study, and the Rockefeller Institute for Medical Research, placing at the disposal of the League department offices and other facilities in surroundings which in some ways recall those in which we worked in Geneva, proved highly propitious for our purpose and was accordingly accepted by the Secretary General. That is how a branch of the technical organization of the League now enjoys the hospitality of Princeton, while the headquarters of the organization still remain in Geneva.

I will not attempt to add anything to the very complete and vivid picture which Mr. Carroll has given of the work done by the Fiscal Committee concerning double taxation. If I were to do so, I would probably quote from the brochure which Mr. Carroll recently wrote and which the League published under the heading *Double Taxation and Fiscal Evasion—Two Decades of Progress*, or from the remarkable report presented by Henry B. Fernald, in 1939, to the International Chamber of Commerce under the title *International Double Taxation.*

The problem of double taxation is undoubtedly important in international business and in interstate business, in federal countries where overlapping tax jurisdictions exist. Its practical significance will be still greater after the war, that is, when the world will be striving to restore a system of international economy and when tax burdens will be very heavy—much heavier than casual or wishful thinking may suggest.

But, as one knows only too well, double taxation is only

one impediment to trade. This is so true that its importance is easily overshadowed by other forms of protectionism.

Since this symposium is concerned primarily with domestic problems, the larger issues of commercial policy, fortunately, need not be discussed here. I will not refer, therefore, to the general work of the League on problems of trade and foreign exchange. But in federal countries many domestic problems arise in very much the same technical terms as international problems. It is, indeed, most interesting to study from a comparative viewpoint the various attempts at solution of certain technical problems in the federal and international plans, respectively.

Apart from the work of the Fiscal Committee, it is possible to mention several pieces of work of various League committees directly connected with the particular subjects discussed here. Two examples are present in my memory—the inquiries of the Communications Committee on coordination of transports and the draft conventions of the Economic Committee on administrative protectionism and customs formalities.

While a student in taxation cannot entirely disregard these questions, at least as a background for his work, certain information concerning the present work of the Fiscal Committee may be of more current interest.

As regards the prevention of international double taxation, the Fiscal Committee meeting which took place in Mexico in June, 1940, seems to promise that, in a future not too remote, a network of bilateral agreements preventing double taxation in business relations of the countries of the Western Hemisphere with one another will begin to spread out as it did in Europe before the war. The Fiscal Committee will contribute to this movement, in the first place, by improving and completing its draft conventions on double taxation,

especially as regards income taxes and death duties; and, in the second place, by creating through its meetings opportunities for the tax administrators of the countries in North, South, and Central America to establish personal contacts similar to those which proved so fruitful in Europe.

But the interests of the Fiscal Committee have not been confined to double taxation. The report of its last plenary meeting of June, 1939, contains, for instance, a summary of an inquiry on the behavior of tax systems in relation to economic fluctuations. The inquiry covered fourteen countries, representative of the different types of economy. The material so assembled enabled the Fiscal Committee to formulate what is, to my knowledge, the first comprehensive analytical statement of the sensitiveness of tax yields to business fluctuations, or, in other words, the influence of economic changes on the productivity of taxation. This information, and the practical conclusions which the Fiscal Committee drew from it, especially as regards the adaptation of tax systems to economic conditions and fiscal policy, should prove of value to governments when drawing up budgetary and financial plans.

At the time when this inquiry on fiscal policy and economic fluctuations was nearing its completion, the Fiscal Committee was requested to investigate the fundamental rules which should govern taxation from a technical point of view. This inquiry was intended for the use both of countries that were still building up their tax systems and of countries that contemplated new tax measures, either with a view to obtaining a better apportionment of taxes or to increasing public revenue.

The method adopted by the Fiscal Committee was to make a clear-cut distinction between the technical problems of taxation and its economic and social aspects. In that way, the recommendations of the Committee could be of

value to all countries, whatever might be their general policies. Furthermore, composed as it was of tax administrators, the Committee wished, above all, to lay out a set of standards or precepts which could be readily followed in practice. Therefore, special attention was paid to the various possibilities and alternatives which offered themselves when a question of adaptation to peculiar geographic, economic, or social conditions arose.

The first part of this inquiry is approaching maturity, and the meeting of tax experts which was convened by the Fiscal Committee in Mexico adopted a draft report on the technical principles governing taxation of income. The program now calls for the consideration of the other direct taxes. Simultaneously, the problems relating to the allocation of tax jurisdiction in federal states will be investigated, in view of the prime importance of such provisions in the structure of tax systems. It should be noted that in this work the Fiscal Committee is most anxious to secure the cooperation of all persons who have special knowledge or experience in taxation. For that reason, the various reports on principles of taxation, before being formally adopted by the Committee, will be sent for observation to a large number of tax administrators, scholars, and other persons particularly well acquainted with tax problems. In that way, it is hoped that when the work of the Fiscal Committee is completed, it will represent a true reflection of world experience concerning the technical problems of taxation.

While the task on which the Fiscal Committee has embarked is long and involves many difficulties, it may, if it is successful, constitute a factor towards uniformity in the tax systems of the various nations, in so far as such uniformity is desirable.

PART SIX

WHAT CAN BE DONE ABOUT TRADE BARRIERS?

CHAPTER XXV

JUDICIAL TRENDS WITH RESPECT TO TRADE BARRIERS

Robert C. Brown
School of Law, Indiana University

The past year has shown not merely a judicial trend but little less than a judicial revolution with respect to state taxation in interstate commerce; and the possibility of trade barriers through such taxation is thus at least considerably increased. This change was accomplished principally by the already famous case of *McGoldrick* v. *Berwind-White Coal Mining Co.*[1] Perhaps this case did not come as a complete surprise, as it had some faint foreshadowing.[2] Nevertheless, it can well be said to overrule the proverbial "century of precedent," since it upheld a New York City sales tax exacted against a Pennsylvania corporation mining coal in Pennsylvania and selling it to New York City consumers, the coal being necessarily transported across the state of New Jersey.

That this transaction involves the most elementary form of interstate commerce is not denied in the opinion of the majority of the Court, written by Justice Stone. (Chief Justice Hughes wrote a dissenting opinion, two of his colleagues concurring with him.) Justice Stone's position is that the state should have full power to tax interstate trans-

[1] 309 U. S. 33 (1940). The companion case, *McGoldrick* v. *Felt & Tarrant Mfg. Co.*, 309 U. S. 70 (1940) adds nothing of importance to our present consideration.

[2] *Western Live Stock* v. *Bureau of Revenue*, 303 U. S. 205 (1938).

actions so long as the tax is not definitely discriminatory or unduly burdensome. He has little difficulty in demonstrating to his own satisfaction that the New York City tax is not discriminatory, and he is almost as sure, notwithstanding numerous authorities more or less to the contrary in past years, that it is not unduly burdensome. Thus the tax was upheld. The issue of major importance is whether this doctrine means substantial trade barriers between the states through the exercise of this at least expanded power of state taxation.

Importance of Problem

Before considering this problem, perhaps a word should be said with reference to its importance. Some people may say, "Granted that we have trade barriers between the states, so what?" The answer is that the most fundamental purpose of the creation of the United States was to do away with the possibility of such barriers. The brief and rather innocent-appearing commerce clause is therefore the heart of the Constitution (or, at least, of the original Constitution).

The Court has often recognized this proposition and has, therefore, definitely condemned all sorts of trade barriers; and this recognition has continued until the present. Thus, Justice Cardozo, speaking for a unanimous court, in condemning a New York statute which attempted to dictate the price paid to Vermont producers of milk, said:

> We are reminded in the opinion below that a chief occasion of the commerce clauses was "the mutual jealousies and aggressions of the states, taking form in customs barriers and other economic retaliation." . . . If New York, in order to promote the economic welfare of her farmers, may guard them against competition with the cheaper prices of Vermont, the door has been opened to rivalries and reprisals that

were meant to be averted by subjecting commerce between the states to the power of the nation.[3]

He added in the same opinion, "One state in its dealings with another may not place itself in a position of economic isolation."[4]

Consequently, while the Court has recognized its duty to presume in favor of the validity of state taxing and other statutes, even though they might conceivably have some effect upon interstate commerce,[5] it has not, at least until recently, had any doubt of its power and duty to strike down any state statutes, tax or otherwise, which interposed substantial trade barriers, and therefore tended toward "economic isolation."[6] Recently, however, Justice Black has argued for the theory that the Court has no right to interfere in such matters; that it is purely a question for Congress. While he does not seem to have obtained much support, as yet, from other members of the Court,[7] yet it would be unsafe to ignore any theory in these days of rapid court changes in personnel and still more rapid changes in judicial doctrines.

Justice Black appears to have first clearly stated his hypothesis in his dissenting opinion in *Adams Mfg. Co.* v. *Storen*,[8] a case which will be later more fully considered, but where the Court, unanimously (except for Justice Black himself) invalidated a state tax on the ground of possibility of multiple state taxes on the same transaction. He insisted that no actual multiple burden appeared, but further

[3] *Baldwin* v. *Seelig*, 294 U. S. 511, 522 (1935).

[4] 294 U. S. 527.

[5] *See, e.g., Milk Control Board* v. *Eisenberg*, 306 U. S. 346 (1939).

[6] *Puget Sound Co.* v. *Tax Commission*, 302 U. S. 90 (1937).

[7] There is some indication, in *Caroll* v. *Dixie Greyhound Lines*, 309 U. S. 176 (1940), that Justices Frankfurter and Douglas have some favor for this theory.

[8] 304 U. S. 307 (1938).

stated that in his opinion it would be wholly immaterial; that multiple burdens and therefore state barriers are all right unless Congress interferes.

His views were made still more explicit in his dissenting opinion in *Gwin* v. *Henneford*.[9] Again he insists that multiple tax burdens are perfectly all right unless Congress decides to interfere with them. Indeed, he suggests that Congress might think they were desirable! At any rate, he is sure that this is not a judicial question.

Is there anything to this theory that the judiciary should not interfere to prevent the states putting themselves in economic isolation? It seems clear that there is not. If a national court is to resign utterly from the function of preventing the states from barring interstate commerce, it is a little hard to see what function of consequence is left for the Court.[10] Certainly, Congress has troubles of its own and can hardly be expected to foresee and legislate in advance against all schemes of trade barriers, by taxation or otherwise, which the ingenious minds in the states might invent. It would be more reasonable to assert that the Court should refuse to invalidate state legislation contravening the Fourteenth Amendment (which is really a comparatively recent interloper in the Constitution) than to fail to interfere with an attack upon the very heart of the Constitution, the commerce clause, and the consequent national protection of commerce among the states. Justice Black's view is therefore not to be taken seriously as a matter of principle; but it hardly follows that it may not have to be considered in attempting to determine what the Court may do in the future. Certainly if this view prevails, the ju-

[9] 305 U. S. 434 (1939).

[10] *See* T. R. Powell, "1939-1940 Supreme Court Decisions on State Taxation of Interstate Commerce," *Bulletin of the National Tax Association*, XXVI (1940), 23.

diciary will give the signal to the states to go ahead and put all the barriers against interstate commerce that they please.

Discrimination Against Interstate Commerce

Nevertheless, that time has not yet arrived, at least visibly. The Court still adheres to its position, taken more than sixty years ago,[11] that the states may not flatly discriminate against interstate commerce, by imposing a burden upon such commerce not shared by activities within the state. To be sure, a state tax upon interstate transactions is not necessarily invalid if balanced by a tax of similar weight upon intrastate transactions;[12] but interstate transactions must not be blatantly discriminated against. This was reiterated recently by a unanimous court in *Hale* v. *Bimco*,[13] where a Florida statute imposing a heavy inspection fee on imported cement was invalidated on the ground that it was actually, and even avowedly (by reason of certain language in the statute), for the purpose of protecting Florida manufacturers. Justice Frankfurter, speaking for the Court, was rather apologetic in his language—a sort of "this hurts me more than it does you"—but, as usually happens on such occasions, the penalty of invalidation was firmly inflicted. Even Justice Black agrees, as is shown not only by his concurrence in this decision but by his express language in the dissenting opinions which have been referred to previously.

Even to this rule there is at least one exception. The Court has held that the peculiar language of the Twenty-first Amendment permits the states to discriminate against interstate shipments of intoxicating liquors.[14] It is possible,

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[11] *Welton* v. *Missouri*, 91 U. S. 275 (1876).
[12] *Gregg Dyeing Co.* v. *Query*, 286 U. S. 472 (1932).
[13] 306 U. S. 375 (1939).
[14] *State Board* v. *Youngs Market Co.*, 299 U. S. 59 (1936).

though not certain, that similar discrimination would be permitted as to goods made by convict labor,[15] and as to that most wicked commodity, oleomargarine.[16] But these amount to decisions that, as to particular commodities, the commerce clause has been repealed. They are therefore not authorities on the interpretation of that clause, though again one cannot deny that they may have some effect in this particular, by analogy.

Nevertheless, judicial limitations on trade barriers are not yet, at least avowedly, done away with. To attempt to predict how far they will be, is hazardous. It necessitates the use of the technique of attempting to predict future decisions by using what the Court has said in the past—a technique always uncertain and, under present conditions, well-nigh useless. Nevertheless, it has to be done, since it is clear that a prohibition of taxation and other burdens avowedly discriminating against interstate commerce does not necessarily involve a prohibition of measures which actually, though not avowedly, have the same effect.

It can be said, however, with considerable confidence that the new doctrine enunciated in the *Berwind-White* case does not necessarily involve discrimination against interstate commerce. The truth is that it can be applied so as to equalize the burden. It is obvious that if intrastate sales are subject to state or municipal sales taxes and interstate commerce is free from this burden the discrimination is in favor of interstate commerce and a sales tax upon such commerce would merely equalize the burden.[17]

But this is all on the assumption that only a single sales

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[15] *Kentucky Whip Co.* v. *Railroad*, 299 U. S. 334 (1937).

[16] But *see* Lockhart, "State Tax Barriers to Interstate Trade," *Harvard Law Review*, LIII (1940), 1253.

[17] *See* Lockhart, "The Sales Tax in Interstate Commerce," *Harvard Law Review*, LII (1939), 617.

tax is imposed—for example, that in the *Berwind-White* case only New York imposes a sales tax. If Pennsylvania could also impose a sales tax, there is a possible double burden on interstate commerce, whereas only a single burden is imposed upon intrastate commerce. The situation of New Jersey may probably be ignored, since no sales tax could possibly be imposed there, nor any taxes other than upon the carriers. Here the burden would be heavier only because of the length of the haul and not because of interstate commerce.[18] But if Pennsylvania and New York can both impose a sales tax upon the same transaction, the burden upon interstate commerce is heavy and possibly crushing. It is in this connection that the recent talk of the Court with reference to "multiple burdens" becomes important.

It is true that some cases, even quite recent, have invalidated such state taxes on interstate transactions on traditional grounds, and without paying much attention to this aspect of the matter.[19] Also, a few cases have considered the point but have nevertheless sustained the tax, on the theory that there was, in fact, no multiple burden.[20] It is the cases where the state tax was invalidated on this ground which therefore merit our special attention.

Of these, the leading one is *Adams Mfg. Co.* v. *Storen.*[21] Here the Indiana gross income tax (which constitutes a sales tax plus, being imposed upon gross receipts from sales and from other activities) was held unconstitutional as applied to an Indiana manufacturer which sent most of its

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[18] *Coverdale* v. *Arkansas Co.,* 303 U. S. 604 (1938). But cf. Lockhart, *op. cit.,* note 16.

[19] *Fisher's Blend Station* v. *Tax Commission,* 297 U. S. 650 (1936); *Puget Sound Co.* v. *Tax Commission,* 302 U. S. 90 (1937).

[20] *Western Live Stock* v. *Bureau of Revenue,* 303 U. S. 250 (1938); *So. Pac. Co.* v. *Gallagher,* 306 U. S. 167 (1939).

[21] 304 U. S. 307 (1938).

products outside of that state. The opinion, written by Justice Roberts, and concurred in by all the court except Justice Black, rests primarily upon the proposition that other states into which the products were sent could impose a similar tax and that there would thus be a discriminatory burden upon interstate commerce.

Somewhat similar, is the more recent decision of *Gwin* v. *Henneford*,[22] invalidating a Washington gross receipts tax on a domestic selling agent for local fruit growers, most of the sales being in interstate commerce. Here, too, the tax was invalidated because of the possibility of multiple burden (by reason of taxes in the states where the fruit was sold), and the opinion this time was written by Justice Stone, Justice Black, as usual, dissenting. That Justice Stone wrote the opinion is important, because he also wrote the opinion in the *Berwind-White* case.

If these cases are adhered to, it is obvious that the *Berwind-White* case does not necessarily threaten tax barriers by the states, since they prevent taxes by the selling state (unless possibly when reasonably apportioned to the activities apart from interstate commerce). The only tax on the sale itself can be by the state of the purchaser, and this is no trade barrier, for it only equalizes the burden with intrastate commerce.

Nevertheless, one is justified in doubting the continued efficacy of both the *Adams* and the *Gwin* cases. In the first place, it is well settled that the state of origin may impose an excise tax upon the business activities there, even though the products are carried in interstate commerce and the tax is measured by the selling price charged to the out-of-state purchaser.[23] Perhaps a Pennsylvania severance tax is not

[22] 305 U. S. 434 (1939).

[23] *American Co.* v. *St. Louis*, 250 U. S. 459 (1919), and cases following it, such as *Utah Co.* v. *Pfost*, 286 U. S. 165 (1932).

particularly troublesome in this connection,[24] but supposing Pennsylvania imposed a substantial excise tax upon the production of coal, would not this result in a heavy burden upon the interstate commerce involved in the *Berwind-White* case? The *Adams* case was distinguished by Justice Roberts from these cases upholding state excise taxes, on the ground that the Indiana tax was a gross receipts tax and not an excise tax. But as to this, one is reminded of Mr. Shakespeare's well-known comment as to the nomenclature of roses.

In the second place, it is difficult to see any greater justification for permitting the state of the buyer to impose a sales tax or its equivalent than the state of the seller. Both states have an economic claim to the tax, and it seems that both (or neither) should be permitted to impose it. To decide in favor of the state of the buyer seems wholly arbitrary, though perhaps it might work reasonably well. But whether the Court will actually do so when this issue is clearly presented to it is hardly certain.

Finally, it is clear that Justice Stone, though he concurred in the *Adams* case, has lost any enthusiasm which he may have originally had for it. This is shown by his opinion in the *Berwind-White* case, where he said with reference to the *Adams* case that the Indiana tax was there held invalid

> because there the court *found* the receipts derived from activities in interstate commerce, as distinguished from the receipts from activities wholly intrastate, were included in the measure of the tax, the sales price, without segregation or apportionment.[25]

Such language indicates that in his opinion the Court "found" something that really wasn't there.

I have always thought that in the *Adams* case the state of Indiana was a victim of its own too enthusiastic Supreme

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[24] Such a tax was sustained in *Heisler* v. *Thomas Co.*, 260 U. S. 245 (1922).
[25] 309 U. S. 57.

Court, which sustained the tax mainly upon the ground that the tax (notwithstanding clear language in the statute to the contrary) was in lieu of property taxes. It is by no means certain that the case would be followed now, and if it is not, there is certainly a serious possibility of multiple tax burdens in interstate commerce and, therefore, pretty effective trade barriers.[26]

Effect of Use Tax Cases

But if such restrictions upon state trade barriers by taxation are still effective, there is apparently an easy way around, by the use tax. Again, this tax is no barrier to interstate commerce, even though it is imposed solely on products brought from outside the state, provided an equal tax is imposed upon domestic products.[27] Nor is it a barrier—it is really equalizing—if the tax is imposed only when no sales tax has been imposed by the state where the goods were sold, or the amount of such a sales tax is deducted from the use tax. Parenthetically, there is no possible objection to a tax by the state of sale, for such a sale is not an interstate transaction.

This was the situation in *Henneford* v. *Silas Mason Co.*,[28] which is the leading case sustaining state use taxes. The Court naturally relied on this provision as showing equality. But Justice Cardozo, speaking for the Court, added the following distinctly disturbing language:

> Yet a word of caution should be added here to avoid the chance of misconception. We have not meant to imply by anything said in this opinion that allowance of a credit for other taxes paid to Washington made it mandatory that there should be a like allowance for taxes paid to other states. *A state, for many purposes, is to be reckoned as a self-*

[26] The doctrine of *Gwin* v. *Henneford* is also under suspicion, for basically the same reasons.

[27] *Gregg Dyling Co.* v. *Query*, 286 U. S. 472 (1932).

[28] 300 U. S. 577 (1937).

> *contained unit*, which may frame its own system of burdens and exemptions without heeding systems elsewhere. If there are limits to that power, there is no need to mark them now. It will be time enough to mark them when a taxpayer paying in the state of origin is compelled to pay again in the state of destination.[29]

Here we have the propriety of multiple taxation through use taxes clearly and avowedly recognized, and the previous prohibition of "economic isolation" of the states seems to be withdrawn.

Still more disturbing is the 1939 decision of *Southern Pacific Co.* v. *Gallagher*.[30] Here the California use tax was involved, and that statute, unlike the Washington statute, makes no allowance for possible sales taxes in other states. Justice Reed, speaking for the Court, stated that this was immaterial, unless the taxpayer was in a position to show that he had actually paid a sales tax in another state. This seems well enough; but Justice Reed clearly indicates that he agrees with Justice Cardozo's intimation in the *Silas Mason* case that such a multiple tax burden would be immaterial, anyway.

It seems clear that the *Berwind-White* decision is really a logical and sensible application of the use tax authorities. If the state can get the same result by the use tax, it would be rather absurd to prohibit it from doing the thing directly through the sales tax.[31] Chief Justice Hughes, dissenting in the *Berwind-White* case, says that a use tax is not directly upon the interstate commerce, but this seems to be a purely formal distinction. Now then, if, as seems probable from language already quoted, the state of origin can impose a sales tax, and the other state a use tax without allowing for the previous sales tax, we have a double burden on

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[29] 300 U. S. 587.
[30] 306 U. S. 167 (1939).
[31] *See* T. R. Powell, *op. cit.*

interstate commerce, and whether it is to be done by a combination of taxes denominated gross income, gross receipts, sales, or use taxes seems wholly immaterial. We have, in effect, a multiple burden on interstate commerce, and the Court might just as well admit it. If so, the *Adams* case and its comrades will go into the great company of the forgotten.

Furthermore, this involves a serious trade barrier. To be sure, it will not prevent the people of New York City (or Chicago) from importing their anthracite coal from Pennsylvania, since there is no other place to get it. But it will be an important and often decisive advantage in favor of securing products from within the state, where possible, and thus avoiding the payment of more than one sales tax. On a highly competitive basis, the amount of one additional sales tax or its equivalent will often be decisive.

Conclusion

The conclusion, if there is one, is therefore rather pessimistic. Judicial trends with respect to trade barriers are all in their favor; and the present personnel of the Supreme Court is not likely to show great enthusiasm in checking this tendency. Justice Cardozo's successors seem far more likely to follow his unfortunate concept of a state as a "self-contained unit" than his earlier but much sounder idea that states must avoid "economic isolation." All prophecies are dangerous, and I hope this one is wrong, but I see no immediate prospect of effective judicial condemnation to trade barriers between the states, at least where such barriers take the form of taxation. I trust that other contributors to the symposium will give us more hope that legislative and similar action will interpose those checks to trade barriers which the courts, I fear, are failing to do.

CHAPTER XXVI

POSSIBILITIES OF ACTION BY LEGISLATURES AND ADMINISTRATIVE OFFICIALS

Hubert R. Gallagher

Assistant Director, The Counsel of State Governments

For years the United States has been known as the greatest free trade area in the world, but today all of us are aware that several hundred trade barriers of various types are obstructing the free flow of commerce among the states. No one knows the exact number of legislative enactments or of administrative rulings which, through interpretation or administration, burden interstate and intercity trade throughout the country. They are enforced generally under the state police and taxation powers to the great benefit of local producers and distributors but to the detriment of our national economy, with the consumer, as usual, paying the bill and with political and economic sectionalism thriving as a by-product. Of course it should be recognized that states must exert a certain control over commerce in order to enforce valid laws directed to valid objectives. The Constitution itself recognized the necessity of state inspection laws. Even the early decisions interpreting that document recognized the validity of state regulation of commerce in certain peculiarly local situations. Later interpretation has broadened, rather than limited, the area of state intervention. The symbols by which it is attempted to differentiate the area of permissible state action from the area of free national commerce have changed from time to time, but the

dilemma inherent in the establishment of this line of demarcation remains.

This trade war among the states is not new in our history. It was so widespread under the Articles of Confederation that Madison wrote:

> The practice of many states in restricting the commercial intercourse with other states and putting their productions and manufactures on the same footing with those of foreign nations, though not contrary to the Federal Articles, is certainly adverse to the spirit of the union, and tends to beget retaliating regulations, not less expensive and vexatious to themselves than they are destructive of the general harmony.

The framers of the Constitution endeavored to take precautions against the recurrence of such a situation when they gave to Congress the power "to regulate commerce . . . among the several states" and specifically stated that:

> no state shall, without the consent of the Congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws; and the net produce of all duties and imposts, laid by any state on imports or exports, shall be for the use of the Treasury of the United States; and all such laws shall be subject to the revision and control of the Congress.

In commenting upon these sections, Chief Justice John Marshall stated: "It may be doubted whether any of the evils proceeding from the feebleness of the federal government contributed more to that great revolution which introduced the present system than the deep and general conviction that commerce ought to be regulated by Congress." And many years later, Roger Taney, also Chief Justice of the Supreme Court, stated: "But further and more mature reflection has convinced me that the rule laid down by the Supreme Court is a just and safe one, and perhaps the best that could have been adopted for preserving the right of the United States, on the one hand, and of the states, on the other, and preventing collision between them."

A century and a half after the adoption of the Constitution, however, state trade barriers have again assumed ominous proportions. They are diverting our economy from the traditional policy of unhampered domestic trade, and are threatening to return us to those conditions which once played havoc with interstate harmony.

The Blame for Trade Barriers

Who is to blame for it all? Possibly the business groups who have wished to protect a home industry in the same way in which in an earlier day struggling American industries were protected by an international tariff. Certainly those individual business organizations which have wished to penalize a competitor located in another state. Certainly those nation-wide organizations, as typified by the transportation services, which, fighting bitterly in a highly competitive field, have resorted to legislative or administrative pressures to make things hot for their competitors. Then there are the local labor organizations, farmers, contractors, and professional groups of all sorts who are looking for aid.

Legislators or administrative officials are usually to blame, even though they are the pawns or goats in the game. By yielding to certain of their constituents, on one hand, and by not being too aware of the wider public interest, on the other, they have been led to introduce measures or adopt administrative rulings, which, though frequently innocent-appearing, turn out in practice to be highly restrictive trade barriers.

Too often, the legislation, when analyzed, appears to be "end-of-session stuff" which is rushed through in the closing hours without being examined critically. A brief speech by its sponsor to the effect that this measure "benefits business"

or is desired by some pressure group, and the bill is on its way to passage. The legislator, in turn, can blame a legislative system which permits such a glut of bills at the session end that careful examination or even the holding of hearings becomes impossible.

The same procedure applies to many of the administrative rulings or orders which are frequently put into effect, sometimes even surreptitiously without benefit of hearing or publication of notice. Our system is also at fault here because, with administrative officials so subject to the whims of politics, it is difficult for the insecure official to ignore the suggestions, or even blandishments, of the business, farm, or labor organizations which may have previously employed him, and may subsequently be asked to do so, come election day or term's end. In a somewhat similar fashion are state legislators often influenced. Indeed, many organizations encourage their politically-minded employees to run for public office, and sometimes the support goes beyond friendly encouragement. Campaign expenditure disclosure laws in some states make clear this condition, which is generally recognized by those familiar with the legislative way of life. The friendships developed, the hard work, the good times enjoyed, unite the legislators, despite partisan lines, far more strongly than most observers realize. Thus, when legislation comes up that would benefit a member, a farm or labor group, or home state industry, to the detriment of some outsider, it is not surprising to see trade-barrier legislation rolling through with little opposition or even consideration. The wonder is that there isn't more of it.

What should be done about it?

First, I would like to point out *what has been done about it.*

Efforts to Cope with Problem

Although for a number of years the problem has been recognized as a serious one by various students of economics and other persons throughout the country, it was not until recently that the general public became interested in, and concerned with, this development. Such interest was, in the main, stimulated by public-spirited state officials and their national organizations and secretariats. Some two years ago, the National Association of Commissioners, Secretaries, and Directors of Agriculture called attention to the great increase in trade-barrier laws among the states. Then the Governors' Conference, in 1938, departed from its twenty-five-year-old custom of not considering resolutions and authorized a statement condemning interstate trade barriers and urging their discontinuance.

In January, 1939, representatives of 46 states, at the General Assembly of the Council of State Governments meeting in Washington, condemned the growth of trade barriers as "detrimental to the economic welfare of the country" and instructed the Council to study the problem and to call a nation-wide conference for its consideration. The subject will again be considered at the General Assembly meeting in January, 1941, and a report of progress made in this field will be given then.

As a preliminary step, early in 1939, the Council organized a committee composed of competent experts to study the subject. It established a research staff to determine the extent, nature, and location of trade-barrier laws and, in cooperation with the Department of Agriculture and the Marketing Laws Survey, which had already undertaken extensive research in this field, it endeavored to assemble, classify, and tabulate all available information. This ma-

terial, from the Department of Agriculture, the Marketing Laws Survey, and the Council, was made available to all state officials and to all state legislatures then in session. An effective educational campaign was organized with the assistance of an excellent committee composed of a number of editors of leading daily newspapers and magazines, and by this means the assembled material was made available to the public.

In April, 1939, the Council of State Governments called a National Conference on Interstate Trade Barriers, which met in Chicago. Two hundred and eighty-five delegates from 35 states and the federal government discussed, in committee and section meetings, existing barriers and made plans for their elimination.

Since the conference was held while a number of legislatures were still in session, it was possible in many instances for the conferees to return to their states in time to put many of the recommendations of the conference into effect. The 44 state Commissions on Interstate Cooperation worked, one with the other and through the Council, in calling attention to trade-barrier legislation pending in the several states and in bringing about its defeat. In fact, so inspired were those who attended the Conference and so widespread was the newspaper and radio publicity that I believe the organizations, interests, and individuals who backed the original trade-barrier legislation were taken by surprise and were not able to organize a counter attack until many barriers were repealed, new ones blocked, and the legislators on their way home!

This national conference has been supplemented, during 1939 and the early part of 1940, by regional conferences on particular types of barriers.

Results of Current Efforts to Minimize Interstate Trade Barriers

The net result of these cooperative efforts was that practically no additional trade-barrier acts were passed by legislatures in session in 1939, and a number of states repealed existing laws. The trend toward further economic isolation among the states has been stopped for the time being.

In fact, with respect to interstate trade barriers, perhaps to a greater extent than in any other field, the states have demonstrated, within the past two years, the practicability of intergovernmental cooperation. Working through their central organization, the Council of State Governments, and with the cooperation of many other organizations of public officials—federal, state, and local—the state legislatures have given much time and attention to the problem, repeatedly defeating measures designed to extend the scope of interstate trade barriers and in many instances repealing those already in effect. In this drive the Council has had the active assistance of many business groups, such as the Business Advisory Council of the Department of Commerce, the United States Chamber of Commerce, the American Bankers' Association, the National Association of Manufacturers, as well as the Tax Policy League, the National League of Women Voters, and various consumer and labor organizations.

The Commissions on Interstate Cooperation, established in 44 of the 48 states and consisting of representatives from the state senates, state houses of representatives, and state administrative departments, have had as their number one objective the elimination of interstate trade barriers. These Commissions have devoted their attention not only to the general problem but have been notably successful in elimi-

nating specific difficulties that have existed among adjoining and neighboring states.

The governors of the several states have taken the lead in this general effort and upon a number of occasions have vetoed, or have announced that they would veto, any legislation which would operate to impede the free flow of commerce or to the detriment of sister states.

To be specific, the Oklahoma legislature repealed its port-of-entry law, and Texas dropped its proposal to establish a similar system. At the same time New Mexico approved legislation permitting the state to enter into reciprocal agreements allowing livestock growers to use their motor vehicles in New Mexico and neighboring states by paying license fees only in their place of residence. It further lowered restrictions on trucks bringing lumber and livestock into the state, while Arizona, its neighbor, defeated a bill to prohibit the transportation of inflammable liquids in motor vehicles in quantities greater than 1,500 gallons.

The strong opposition of the New York Joint Legislative Committee on Interstate Cooperation prevented the passage of seven trade-barrier bills of various types, the most notorious of which was a measure requiring that all materials to be used in the construction of public buildings, which were not mined or quarried in New York, must be fabricated and finished within the state. In Ohio, a proposal to limit the purchase of coal for state institutions to that mined in Ohio was defeated as a result of the work of the Cooperation Commission. Public purchase preference bills were defeated in Connecticut, Texas, and Kansas. New Hampshire refused to pass a bill discriminating against out-of-state salesmen.

Oregon and Vermont lawmakers defeated bills imposing an oleomargarine tax, and Iowa defeated a proposed in-

crease of taxes on this product. Mississippi, during the 1940 session, repealed its oleomargarine tax. Duties or inspection fees levied on farm products of other states were defeated in Arkansas, California, Florida, and Rhode Island. The agriculture departments of the western states are cooperating in an effective effort to eliminate discriminatory quarantines.

Indiana repealed its liquor port-of-entry system law which had been the cause of so much ill feeling on the part of its neighbors, and almost immediately Missouri followed with the repeal of its so-called anti-discriminatory liquor statute. Illinois has recently revised its administrative practices with respect to the transportation of liquor, to conform to those of neighboring states.

The Council of State Governments has also made progress in unifying milk inspection rules, regulations, and standards of the midwestern states. Meetings have been held with dairy commissioners and health officials for the purpose of improving the quality of milk and cream shipped from this area to eastern markets. In the past, shipments have occasionally been barred because they have allegedly failed to comply with inspectional standards set in other sections of the country. These restrictions are seldom enforced when there is a milk shortage in the East, but they ordinarily serve as restrictive barriers on milk shipments to eastern markets. By unifying and raising inspectional standards, in the midwest section, it is hoped that these barriers may be torn down.

Through administrative regulations even the hatching of baby chicks has been protected by the home state. In the Far West the Council was able to get agriculture commissioners and others to relax this type of restriction.

Spirit of Cooperation in Evidence

Of possibly greater importance for the future than the number of specific trade barriers which have been turned aside this year, is the spirit of cooperation which has been displayed by governors and legislators of so many states during 1939 and through 1940. The Maryland General Assembly passed a resolution which called upon each of the states to discourage the erection of barriers, and Florida declared its opposition to any measure directly or indirectly establishing any trade barrier between Florida and any other state. New York and Pennsylvania, at a meeting early in 1940, adopted a policy to the effect that neither state would adopt any trade-barrier practice which would in any way discriminate against out-of-state products.

It is apparent from the foregoing that a beginning, and a very good beginning, has been made in this common effort to re-establish a free trade area throughout the United States. Because of the interest and cooperation of newspapers and periodicals, the radio and news reels, the average citizen, as well as the legislator, is acquainted with the problem. Little, if any, new legislation of this type has been adopted during recent sessions of state legislatures, and in some instances particularly obnoxious laws have been repealed. Hundreds of statutes, however, are still on the books in the several states, many of which, in their enforcement, tend to limit the markets, tax the consumer, and undermine our general economic system. Much, however, remains to be done. The gains already made must be retained and new attacks on the problem initiated.

On the legislative side the Council of State Governments, through the Governors' Conference, the National Association of Attorneys-General, the National Association of Sec-

retaries of State, and the Commissions on Interstate Cooperation, expects to continue its work in this field, which is but a part of its broad program for making government more effective and intergovernmental cooperation a reality.

Many difficulties have been encountered by the states, however, in this effort, not only because of the many and varied business and commercial interests involved, but also because of our complicated, sometimes inadequate, and many times conflicting tax systems—federal, state, and local. And for these reasons, it has been generally realized that a comprehensive solution of the problem requires not only federal participation but federal cooperation with the states and the local governments.

In this connection it might be pointed out that while federal officials and others have been pointing to state barriers to trade, the officials of some of the states have been attacking the rate zones of the Interstate Commerce Commission as the most grievous internal trade barrier in the nation. It should also be remembered that some state barriers, whether for legitimate or discriminatory purposes, have been sanctioned by Congress through the device of Congressional consent.

Other federal governments have been struggling with these problems. In Australia, where trade barriers between states are prohibited by law, the same subterfuges have been used, with the result that the disruption of the country's economy has been worse than here. So chaotic has the condition become that a proposal has been made by some of the most influential men in Australia to abolish entirely the governments of the six states which make up the commonwealth and set up in place of the present federalism a single centralized government. Canada also has been grappling with this and similar problems for some years, and Par-

liament is now giving consideration to the report of the Royal Commission on Dominion and Provincial Relations which, after several years of investigation, has made recommendations for alleviating federal-state conflicts of all sorts in the Dominion.

Effective solution of our trade-barrier problem can be had only by joint action of national and state governments, and in order to explore this complicated problem in its many aspects and to develop "a national policy fair alike to the states and our Union," the Council of State Governments has recommended to the Congress the establishment of a continuing Committee on Federal-State Relations. Such a committee, it would seem, could very well follow the pattern of the Temporary National Economic Committee and consist of representatives from the Senate, the House of Representatives, and the administrative branch of the government. This committee, if established, could work in cooperation with the organization representing the states, namely, the Council of State Governments, and could survey the entire situation in all of its ramifications, with the idea of presenting to the next Congress a comprehensive plan looking toward cooperation and participation by all levels of government, which, it has been clearly demonstrated, is necessary for a practical solution of the problem of interstate trade barriers.

As Frank Bane, Executive Director of the Council of State Governments, has said in appearing before Congressional Committees and otherwise:

> It would be our hope that such a Committee, if established, would not confine itself exclusively to this one problem, but, in cooperation with the Council of State Governments and other interested organizations, would explore other major questions of federal-state relationships so pertinent to the effective operation of our government—problems arising from conflicting and overlapping tax laws, grants-in-aid and their

effect upon education, highways, health, and welfare, as well as general state and federal services, the development and coordination of our various systems of transportation, and problems of personnel inherent in the federal, state, and local cooperative government which we have developed.

It is apparent that such a committee, concerning itself with the general problem of federal-state relationships, would constitute an agency through which difficult problems could be solved, and through which our entire governmental machinery could be made to work more efficiently and economically for the common good.

CHAPTER XXVII

FEDERAL PRESSURE FOR UNIFORM LAWS

Reynold E. Carlson

Department of Political Economy, The Johns Hopkins University; Formerly Director of Research on Trade Barriers, Harvard University

The prospect of evoking action or intercession by the federal government in the matter of interstate trade barriers will be viewed according to the preconceptions of the particular individual or group studying the problem. To some, federal action will be like Aladdin and his magic lamp, the mere rubbing of which produces a monstrous Genie, calculated to strike fear into the hearts of state administrative officials. Grave consequences are expected to follow if the Genie, upon being requested to return to his lamp should refuse to do so. To another group, federal action is like Sir Galahad, riding to the rescue of interstate commerce which has allegedly bogged down in a maze of arbitrary and conflicting state laws. Particular industries which have been defeated in the courts or in the state legislatures in their efforts to preserve the substance, as well as the fiction, of a single national market for their commodities will cheer this new ally. They hope that his prestige, and if necessary his force, will eliminate the legal obstacles which have been placed in their paths.

Some of the major tax barriers to the free flow of commerce among the several states have been indicated. The instant task is to explore the federal arsenal to ascertain what weapons are available for any action which Congress

might be persuaded to undertake. There are, primarily, two major sources of power at the disposal of Congress: first, legislation under the commerce clause of the Constitution; and second, legislation under the taxing and spending powers imputed to the federal government by the Supreme Court's interpretation of the Constitution.[1] The balance of this presentation is devoted to a discussion of these alternatives and some of their economic consequences.

I. Commerce Power

There is a long tradition of increasing uniformity of action among the states by the extension of powers to be exercised by the national government. Amendments to the Constitution have conferred new powers, and Supreme Court decisions have enlarged the old, so that the framework of government might keep step with the rapid growth of an integrated and national economy. Examples may be cited, such as the Federal Bureau of Narcotics, the Interstate Commerce Commission, including the Motor Carrier's Division, the Federal Trade Commission, and many others, where a substantial degree of uniformity prevails in areas once characterized by complete diversity of state laws.

Changing Attitude of Supreme Court

A new factor entered the situation in the changing attitude of the Supreme Court which gave rise to a number of decisions upholding state laws although they apparently impinge upon the federal realm of interstate commerce. This new position holds that Congress, and not the Court, should declare the extent to which interstate commerce may be protected from state action. It is succinctly stated in a

[1] *Massachusetts* v. *Mellon,* 262 U. S. 447 (1923).

dissenting opinion that has subsequently become the position of the majority of the Court:

> Congress, alone, can in the exercise of its plenary constitutional control over interstate commerce not only consider whether such a tax as now under scrutiny is consistent with the best interests of our national economy; but can also on the basis of a full explanation of the many aspects of a complicated problem devise a national policy fair alike to the states and the union . . . the remedy, if any is called for, is within the ample reach of Congress.[2]

Thus the Court is no longer an umpire looking out for the interests of the sleeping partner in the federal system; it merely shrugs its shoulders and indicates the giant must bestir himself to keep his special domain intact from the encroachments of the other partners. The result of this position has been to set very wide limits to state laws in the absence of any Congressional action designed to occupy the field allotted to it. This has provided fertile soil for the growth of interstate trade barriers which have multiplied and prospered.

Possibility of Congressional Action

With the issue thus firmly laid at the door of Congress, what specific types of action might be undertaken under the Commerce power?

With Respect to Inspection Laws

First, inspection laws might be enacted for plant and animal quarantines, dairy products, and motor vehicle equipment, which would supplant all state laws relating to such items moving in interstate commerce. The great problems of inspection requirements, which also constitute financial burdens wherever fees and taxes are levied, lie in the diversity of state laws. A federal law might prescribe

[2] *McCarroll* v. *Dixie Greyhound,* 309 U. S. 176 (1940).

certain minimum standards to be administered by a federal agency. Uniform health regulations for the production and shipment of dairy products over the country would eliminate the arbitrary taxes and fees which must now be paid as a condition to supplying specific markets. All commodities or vehicles meeting those standards cannot be barred from interstate commerce, although the states are still at liberty under their police powers to set higher standards so long as they are enforced upon local commerce as well as on interstate commerce. Federal uniformity in this area, such as stabilizing safety requirements for motor vehicles, would go a long way toward solving the port-of-entry issue which is so irritating to motor carriers and highway shippers, to say nothing of the cost to them of repeated delays and compliance with conflicting requirements.

With Respect to Property Classification

Second, federal legislation might be enacted to protect commodities from the discrimination which may arise when states classify property for purposes of taxation. This right to classify property provides the states with a powerful weapon which can be used for discrimination. So long as such provisions are deemed reasonable, i.e., pass the test of due process, the effects on interstate commerce are ignored. The only relief then is federal action to clarify the meaning and extent of interstate commerce with respect to such commodities or services.

a. Motor Vehicles

Attention may be directed to several instances in which such discriminations appear. First, and foremost, there is the case of motor vehicles. States may levy flat license fees upon motor carriers, as compensation for use of the high-

ways. These taxes are levied upon the privilege rather than the extent of use as measured by mileage. Now the license fees are graduated upward with the size and weight of motor carriers, and the Supreme Court has declared due process to be the only limitation upon the state's choice of classification. The Court will pay no attention to the corollary effects such a classification may have upon interstate commerce.

For economical operation on long hauls, heavier vehicles are usually employed by interstate shippers, hence a higher tax on heavy vehicles indirectly discriminates against the channels of interstate commerce. It is almost impossible for an individual to prove the classification unreasonable, and so the tax is levied. If it can be demonstrated, and it probably can, that an interstate carrier pays more for the use of the roads than intrastate carriers, there is surely discrimination. Moreover, the cumulative effect of successive state fees is undoubtedly a factor which limits the radius of operation and services rendered by motor carriers.

Because the states evidently have wide powers of taxation, together with their plenary police powers, federal pressure under the commerce clause is less easy to see. Yet the national government is necessarily concerned with the general level of taxation of interstate carriers, and when an economic institution assumes national proportions it creates a presumption for national regulation. Recent dissents in the Supreme Court suggest that the taxing power of a state can be restricted if, through the very diversity of such powers, it burdens interstate commerce.[3]

Congress might enact a law and declare common and contract carriers listed with the Interstate Commerce Commission as instrumentalities of interstate commerce and

[3] *Gwin, White & Prince* v. *Henneford,* 305 U. S. 434 (1939).

design a tax program to meet the peculiar conditions of such an industry whose primary object is the transportation of commodities in interstate commerce. Whether federal action declaring an industry to be invested with a national interest would force the states to give ground in their tax policy, is, of course, problematical. Its validity would rest upon the willingness of the Supreme Court to stake out the areas of the national economy which fall directly under the commerce clause, and reserve them for the exercise of federal power.

b. Margarine

The taxation of margarine is a second instance where the court upholds a state law if it meets the due process requirement. Thus a state may enact a prohibitive tax on margarine, and, since it applies to domestic as well as to outside margarine, there is no issue of interstate commerce. Yet it is obvious that a heavy tax on margarine is actually a tariff barrier against butter substitutes and dams the flow of interstate commerce.

The possible scope of federal pressure under the commerce clause is still more difficult to see in this case. Perhaps Congress might be persuaded to take a position and declare that a specific list of commodities, including margarine, must be permitted the full protection of interstate commerce, including the right to import and consume in any state. Prior to the Eighteenth Amendment some states were dry, and yet they were powerless to stop the inflow of alcoholic liquor in interstate commerce until Congress gradually withdrew its protection. The practical effect of margarine taxes in some states is absolutely to prohibit the importation and use of a commodity which might otherwise move in interstate commerce. Now if Congress could withdraw its pro-

tection in the case of one commodity—alcohol—it can enforce its protection in the case of another commodity—margarine. If Congress should enact a law indicating its wish that margarine move freely in interstate commerce, the Supreme Court might reconsider the effects of state taxes upon such commerce and find them an unreasonable burden.

c. Marketing

A third instance is the taxation of different methods of doing business, principally in marketing. Because the tax pertains to local business, there is no question of interstate commerce. The court upheld a heavy tax levied on transient merchants, where no such tax fell on established storekeepers. Once again, the indirect or corollary effects upon interstate commerce are ignored; there is a high probability that most transients are likely to be from other states or are apt to represent principals in other states. Hence, a discrimination against transients has consequences for the free flow of interstate commerce. Likewise, in the case of chain stores, the state classification was held reasonable (due process), so that stores in a given state might be forced to pay a tax graduated according to the total number of stores in the whole country. This rule has serious implications for the movement of goods in interstate commerce.

Finally, a state may levy taxes upon financial subjects, as in the case of bank deposits. If the classification is adjudged reasonable, a state may tax deposits in its banks at one rate and deposits held in other states at a higher rate. The result is to discriminate against the free flow of bank credit across the state lines.

Federal pressure under the commerce power in the latter

cases of transient merchants and bank deposits might take the same form as in margarine, namely, a declaration that the movement of these services or commodities over state lines is essential to the national interest. It would then remain for the Supreme Court to consider whether the effects of specific state taxes would impede the avowed purpose of Congress to maintain the free flow of commerce throughout the country.

With Respect to Taxation of Corporations

Recent developments in state taxation of corporations suggest a third major area in which federal action under the commerce clause is becoming more and more necessary to prevent substantial burdens from falling upon interstate commerce. It might be said that discriminatory taxation of foreign corporations outweighs in magnitude of importance many of the more dramatic instances of state trade barriers with which the literature is occupied. Tax competition between states frequently takes the form of reaching out beyond the jurisdiction of the state to tap new resources of revenue.

Wide latitude of choice in selecting allocation formulae is the immediate source of difficulty, for it exposes interstate business to probable multiple taxation. Each state will obviously devise its formula to yield the greatest revenue and this diversity in state tax systems threatens a single unitary corporation with multiple tax burdens. A recent Supreme Court decision[4] increases the possibility of discriminatory tax burdens and threatens to resurrect the old controversies over allocation of corporation income between the states.

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[4] *Ford Motor Co.* v. *Beauchamp*, 308 U. S. 331 (1939).

Just as in the case of motor carriers, the great diversity of state tax systems constitutes a barrier, first, in the use of different bases of computing tax liability, which leads to multiple taxation, and second, in the high cost of complying with the specific conditions imposed by 48 states. This lack of uniformity clearly results in injury to corporations carrying on business in interstate commerce.

So long as corporation taxes were nominal, the burdensome effects of such lack of uniformity were not serious. But at the present rates of state and federal taxes on corporations, which will probably continue to rise, multiple taxation assumes major importance. It has its roots not in the fiscal capacities of the several states but in the divided jurisdiction and the clumsy attempts to divide and tax objects which are not economically divisible. Consequently, federal action under the commerce clause might be brought in the near future with some assurance that it would be effective in remedying the situation. Suffice to say, if any permanent stability in corporation taxation is to be achieved, it can only be done by national inquiry and national action. Congress, alone, can decide, under its plenary commerce power, "whether multiple taxation is injurious to the national economy"; it, alone, can set up uniform rules and regulations covering the taxation of an institution which does business over the entire country.

Limitations of time and space do not here permit an extended analysis of this problem, but one suggestion might be made. The federal government by asserting its commerce power could withdraw from state taxation the operations of any national corporation doing business in interstate commerce. The states might still tax the corporation on its real property or levy other minor license fees, but the present state franchise tax based on the earnings or opera-

tions of the corporation would be eliminated.[5] It is these latter taxes that create the chaotic conditions under which corporations must operate today. A single formula might be used by the federal government for the entire corporation which would vastly simplify the tax structure and result in substantial savings. If desired, the federal tax revenue could then be rebated in whole or in part to the states to reimburse them for the loss in revenue. The validity of such federal action, as always, rests upon the Supreme Court interpretation, but there is a strong presumption that the present court might recognize the essentially national character of corporations and allow Congress to exercise exclusive power in its prescribed domain of interstate commerce.

Specific Constitutional Grounds for Congressional Action

Before proceeding to the second major resource of the federal government in attacking trade barriers, namely, the taxing and spending power, it will be instructive to digress briefly and consider some specific constitutional grounds for Congressional action. Discussion may be limited to highways and sizes and weights of motor carriers. Uniformity of weights and sizes, while not directly connected with tax burdens, does have a great effect upon the costs of operation and the efficiency of performance of the motor carrier industry, a relevant subject for economic discussion.

Legislation Based Upon Commerce Clause

Federal legislation for uniformity might be based either upon the commerce clause or the authority over post roads conferred upon the national government. It has been well

[5] A similar scheme is being advanced as a solution to corporation taxation in Canada. Cf. *Report of the Royal Commission on Dominion-Provincial Relations*, Bk. II, 1940, p. 113.

established that powers relating to the common defense or the general welfare cannot of themselves support federal legislation;[6] they serve rather as adjuncts to the taxing and spending power.[7] The state's interest in its highways has long been recognized and was reaffirmed as recently as April, 1940, by the Supreme Court.[8] Consequently, it may be argued that federal action would regulate the highways, forcing the state to assume costlier burdens or permit highway destruction by heavy carriers. Such would have the effect of influencing state policy and so be beyond the power of Congress. Highways are state instrumentalities built to further a state's policy and are protected by state sovereignty. Moreover, being state property they, like all private property, enjoy the protection of the due process clause in the Fifth Amendment.

The counter argument is surely plausible, however, for both protections—state sovereignty and the Fifth Amendment—operate merely as limitations upon the federal government. Property while under the due process clause is still subject to the reasonable exercise of federal powers such as control interstate commerce. Furthermore, the Fifth Amendment does not avail against injuries which are indirect and incidental, and applies only to an actual "taking" of the property or its complete destruction. The "reasonableness" of federal action is left in the final analysis to the Supreme Court.

Legislation Based Upon Authority Over Post Roads

The federal interest is clearly greater in that portion of highly improved highways over which the bulk of interstate traffic flows than in the total network of roads. Surveys

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[6] *Jacobson* v. *Massachusetts,* 197 U. S. 11 (1905).
[7] *U. S.* v. *Butler*, 297 U. S. 1 (1936).
[8] *Maurer* v. *Hamilton,* 309 U. S. 598 (1940).

completed in June, 1940, by the Motor Carrier Division of the Interstate Commerce Commission demonstrate that relatively few routes carry the greater portion of the heavy interstate traffic. The power of Congress over commerce, while absolute, need be exercised only with reference to a selected grid of highways spread over the country in accordance with traffic needs. The presumption of federal power over the highways under the commerce clause assumes added force when the matter of federal aid is taken into account. Vast amounts of federal money have been poured into highways for the past 24 years. Thus the inherent plenary power of the government regarding national uses of the highways is bolstered by the equity or "proprietary" interest it has acquired in those same highways when constructed out of federal money.

Federal action with respect to sizes and weights might take the form of setting a single national standard; or it might set a variable standard to meet the requirements of different regions; again, it could set minimum standards as a floor below which state legislation might not go; finally, it might legislate complete coverage for all roads or restrict itself to a national highway grid as having the greater federal interest. Having legislated on the general subject, it might delegate the power to fill in details to some central administrative agency or, better, to the states themselves. The latter plan would have much to commend it, in allowing a certain flexibility of operation to meet peculiar local conditions.

Attention must be directed to a point of emphasis which is frequently advanced by writers on motor vehicle trade barriers, and which really obscures the essential economic reason for the existence of diverse and conflicting state laws on size and weights. To cite one quotation: "The lack of

uniformity of state motor vehicle codes is the primary cause of this form of hindrance to interstate shipments."[9] On the contrary, lack of uniformity is not a cause; it is a symptom. Treating it as a cause conveys the erroneous impression that a solution is easy—simply establish uniformity between state laws on size and weights, just as uniformity was once established in the matter of traffic lights. But the difficulty is really more basic than that; it is, at heart, an economic and not a legal problem. The real cause for lack of uniformity is the great variation which exists in the fiscal capacity of the several states to provide highways which are of sufficient quality to permit the movement of heavy traffic. A cursory examination of states having low weight limits shows a striking direct correlation with the states (especially in the Southeast) which rank low in economic resources. They cannot afford highways up to the standards which more prosperous states can enjoy. It is extremely important to recognize this economic basis to the problem lest we be too sanguine about the possibility of federal action curing at one stroke a condition which admittedly is a source of costly and inefficient operation. To remedy the symptoms without considering the underlying causes is worse than no remedy at all. Whether the national economy is financially able to remedy the causes at the present time is doubtful to say the least; but such questions raise a whole new series of problems beyond the scope of the present investigation.

II. Taxing and Spending Power

We may now turn to the second major weapon which the federal government can use to bring pressure upon state

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[9] F. Eugene Melder, "Trade Barriers Between States," *The Annals,* CCVII (1940), 56.

legislatures for uniformity of laws. Briefly, this entails the use of grants-in-aid from the federal to the state governments. This device is specially effective in those areas where the federal government has no other clear constitutional power to attack alleged trade barriers. Grants-in-aid provide a powerful engine for standardizing state legislation and can be used as a kind of economic sanction against those states which persist in the blocking of the flow of trade.

Enumeration of Possibilities

Several possibilities may be mentioned in which the federal grants can impose conditions designed to eliminate specific trade barriers. First, there is the case of dairy products or farm commodities which are discriminated against by taxes and inspection fees. It is conceivable that benefit payments to farmers under the soil conservation program might require the removal of all state discrimination against the interstate movement of such commodities.

Second, with respect to motor carriers, the power of the purse supplements the federal control over interstate commerce. Highway grants might require the free movement of motor vehicles over federal aided highways up to certain sizes and weights set by the Interstate Commerce Commission. With reference to taxation, two possibilities emerge: The federal government might promulgate some scale of classification and rates of taxation for motor vehicles. This plan would then be put up to the several states, and future highway grants made conditional upon its adoption. A similar result might be obtained by increasing the federal excise on gasoline, refunding portions of the revenue to states that provide satisfactory legislation.

Again, the federal government might exercise jurisdiction over interstate motor carriers and levy taxes directly. The

proceeds might then be rebated to the states on some basis such as ton mileage, operated in that state. Such a plan would not lighten the total tax burden on the trucking industry but would eliminate the lack of uniformity in state taxation which now plagues the motor carriers. The Motor Carrier Act of 1935 provides a suitable framework for some such regulation and taxation of common and contract carriers, whereas the Motor Carrier Division of the Interstate Commerce Commission would be a logical administrative agency.

In the case of the liquor industry, there is no longer any protection of the federal government under its commerce power. The Twenty-first Amendment as construed by the Supreme Court completely divests alcoholic beverages of their immunity as commodities in interstate commerce. Yet the federal government might conceivably increase its excise taxes on liquor and share a portion of that revenue with cooperating states. Or some tax-offset scheme might achieve the same result and eliminate discriminatory state taxation.

This enumeration of weapons in the hands of the federal government is by no means intended as an endorsement of their use in shaping government policy. The expanding reliance upon grants-in-aid is an obvious phenomenon, and we can expect to go much further in this direction. Questions of government policy, however, involve so many variables that no blanket rule can be laid down in advance. Much is being written today about the "new federalism," and many state officials have serious apprehensions as to the end result of too-ready acceptance of federal largess. It must suffice here to call attention once more to the political and economic implications of grants-in-aid as they are explored in the rapidly growing literature on the subject.

Federal Leadership versus Federal Pressure

A useful distinction can be made, however, between federal leadership and federal pressure. The essence of leadership is the overcoming of state inertia by offering inducements of various sorts, to effect some general policy over which there is no great dispute. Many instances of federal-state cooperation might be cited as examples of this leadership, such as federal housing, credit and relief agencies, soil conservation, and so on.[10]

The exertion of federal pressure is quite another matter. The use of grants-in-aid for clearing state obstacles from the free flow of interstate commerce implies a punitive or "cracking down" attitude in the federal government. It would introduce a new and onerous type of condition to those usually associated with subsidies to states; the federal requirements would probably be forced in the face of opposition from state and local governments. It is the consensus among qualified students of the grant-in-aid device that it cannot be used successfully in new and controversial spheres, especially where uniformity of administration is required between states. Some consensus between state and federal government on matters of policy is a requisite to the successful operation of a grant-in-aid.[11] Otherwise, stresses and strains will develop and make impossible any union between national interests as viewed by Congress and state interests as viewed by groups exerting pressure on their respective state legislatures.

Examples of Federal Pressure

Notwithstanding these arguments, the fact remains that grants-in-aid, bristling with conditions, have been used to

[10] R. L. Mott, "Uniform Legislation in the United States," *The Annals*, CCVII (1940), 79-92.
[11] V. O. Key, *The Administration of Federal Grants to States*.

put across policies which were partially or wholly distasteful to the recipient states. A few outstanding instances of such federal pressure may be noted. First, the amendments to the Social Security Act in 1939 required states to adopt a personnel policy based on the merit system in all their unemployment compensation and public assistance offices. New York State vigorously opposed the regulation but had no alternative except to yield to the power of the purse. Every small unit of local government had to comply, for the defection of any one might make the whole state ineligible for federal aid.

Second, certain amendments to the Hatch Act were passed in July, 1940, which prohibited all state and local employees directly connected with any activity financed wholly or partly by the federal government from "assisting" in the election of federal, state, or local officials.[12] This is clearly an example of a uniform national policy being imposed upon all states as a condition of federal aid.

Third, the Hayden-Cartwright Act, passed in June, 1934, provided for special emergency grants of federal money for highway construction. The condition imposed was that motor vehicle taxes collected by the state on registrations, fees, licenses, and gasoline must be expended upon the improvement and maintenance of highways to the same extent that such revenues were applied when the federal act was passed. Thus, an arbitrary floor was established below which "diversion" of taxes could not go; this lower limit was represented by the amount of motor vehicle taxes allotted to highways by each state in June, 1934. Any increases in revenue over this amount were, of course, available for state expenditure without restriction so far as the federal government was concerned. A great hue and cry arose from the

[12] V. O. Key, *Public Personnel Review,* October, 1940.

states over this unprecedented "federal interference with state fiscal policy," and the law was subsequently amended so that only unmatched grants carried this condition. Yet in 1938 under this act at least two states, Massachusetts and New Jersey, were penalized by withholding portions of their federal aid.

An identical situation exists in the Pittman-Robertson Act of September, 1937, also known as "Federal Aid to Wild-life Restoration." Federal grants are available only on the condition that all revenue from state hunting licenses be used entirely for the state wild life conservation department. Evidently, the amount of taxes so earmarked is a relatively small part of the revenue sources for any single state, with the result that the same stiff opposition has been lacking. For the whole country, however, these hunting licenses are a substantial item of revenue, producing about twelve million dollars annually. Nevertheless, for the immediate purpose of showing the potentialities of federal pressure, it is instructive to notice one act was passed in 1934 on highways and another in 1937 on wild life, both emphasizing the same principle despite the strong state objections to the first act.

A final example of federal pressure may be cited, although it has long been accepted by the states. The Federal Highways Act of 1916 introduced the policy of regular federal aid to states for highway construction. The local character of highway responsibility in the various states soon proved unsatisfactory, so, in 1921, amendments were passed requiring states to establish a state highway department with full power and responsibility for the expenditure of funds. Three years were allowed for the states to change their constitutions and enact the necessary legislation. An internal struggle developed in some states over such capitulation to federal edict, and Congress conveniently advanced the

effective date for withholding grants until such states could settle their difficulties. It was not until 1929 that this was finally accomplished when all states had complied with the conditions set by Congress and the penalty clauses became operative.

CONCLUSION

It should be evident from this brief survey that the federal government does possess great powers for pressure upon state legislatures for the enactment of uniform laws relating to interstate commerce. In some areas the plenary power of the commerce clause is adequate foundation for federal action, while in other sections where this basis is not available, the potential uses of the taxing and spending power are great indeed. Federal action is usually viewed with alarm, for it leads to greater centralization; yet to exercise a power which the government has always held is hardly to increase centralization. Moreover, the expansion of the new powers through the grant device is still controlled by Congress in which there are still a House of Representatives and a Senate—the dwelling place of many states rights champions.

The old political methods of dealing with national economic problems are fast becoming inadequate. The next steps might well be: First, the formulation of a dynamic theory of economic development based perhaps on such work as is being done by the National Resources Committee; and second, the coordination of the many parts in the political system to keep pace with these changes in the body economic. If the present crop of interstate trade barriers serves to crystallize the problem and to reorient our thinking along these lines, it will have conferred a great service to the nation.

CHAPTER XXVIII

JOINT FEDERAL-STATE ATTACK UPON TRADE BARRIERS

PAUL T. TRUITT

United States Department of Commerce; and Chairman, Interdepartmental Committee on Interstate Trade Barriers

THE discussion of any joint federal-state attack on trade barriers should include a brief examination of the basic factors which make such an approach desirable from a practical point of view.

CONCEPTS OF REGULATORY POWER

The Congress has been given plenary power over interstate commerce in Article I, Section 8, of the Constitution. The most recent doctrine relating to the exercise of this regulatory power of Congress over interstate commerce is set forth with clarity and emphasis in *South Carolina* v. *Barnwell Brothers*[1] and in the minority opinion of *McCarroll* v. *Dixie Greyhound Lines*.[2]

The Court, in the former case said:

> The Commerce clause, by its own force, prohibits discrimination against interstate commerce, whatever its forms or method, and the decisions of this Court have recognized that there is scope for its like operation when state legislation nominally of local concern is in point of fact aimed at interstate commerce. . . . Congress, in the exercise of its plenary power to regulate interstate commerce, may determine whether the burdens imposed on it by state regulation, otherwise permissible, are too great, and may, by legislation designed to secure uni-

[1] 303 U. S. 177.
[2] 60 Sup. Ct. 504, February 12, 1940.

formity or in other respects to protect the national interest in the commerce, curtail to some extent the states regulatory power. But that is a legislative, not a judicial, function, to be performed in the light of the Congressional judgment of what is appropriate regulation of interstate commerce, and the extent to which, in that field, state power and local interests should be required to yield to the national authority and interest.

In *McCarroll* v. *Dixie Greyhound Lines,* Justice Black stated in the minority opinion:

> The making of these exacting judgments is the business of legislation . . . that of state legislatures and of Congress. . . .
>
> This case again illustrates the wisdom of the founders in placing interstate commerce under the protection of Congress. The present problem is not limited to Arkansas, but is of national interest. Maintenance of open channels of trade between the states was not only of paramount importance when our Constitution was framed; it remains today a complex problem calling for national vigilance and regulation.
>
> Our disagreement with the opinions just announced does not arise from a belief that federal action is unnecessary to bring about appropriate uniformity in regulation of interstate commerce. Indeed, state legislation recently before this Court indicates quite the contrary.
>
> Spasmodic and unrelated instances of litigation cannot afford an adequate basis for the creation of integrated national rules which alone can afford that full protection for interstate commerce intended by the Constitution. We would, therefore, leave the questions raised by the Arkansas tax for consideration of Congress in a nation-wide survey of the constantly increasing barriers to trade among the states. Unconfined by "the narrow scope of judicial proceedings," Congress, alone, can, in the exercise of its plenary constitutional control over interstate commerce, not only consider whether such a tax as now under scrutiny is consistent with the best interests of our national economy, but can also on the basis of full exploration of the many aspects of a complicated problem devise a national policy fair alike to the states and our Union.

Concurrently, the states have sovereign regulatory powers which may or may not now be exercised in harmony with the laws of sister states and with federal law in a given category. As further stated in the *McCarroll* case, "Diverse and

interacting state laws may well have created avoidable hardships."[3]

Between these two concepts of regulatory power exercised by different and distinct levels of government, there exists what has been called an intergovernmental zone. It is in this zone that the many "diverse and interacting state laws" lacking uniformity with existing federal laws have been enacted.

In addition, non-uniform state laws in areas not yet occupied by federal legislation add their burden as trade barriers to interstate commerce.

Essentially, the solution of this problem is one which requires the harmonizing, on an equal and fair basis, of the regulatory burdens placed on both interstate and intrastate commerce, by the proper exercise of the Constitutional regulatory powers of the federal government and the sovereign regulatory powers of the several state governments. Further, since there has been an infiltration of trade-barrier practices into lesser political jurisdictions, the regulatory powers of cities, counties, and even towns and villages, are involved. These, too, must be revised accordingly in any completely successful plan to eliminate trade barriers.

Intergovernmental Cooperation

Historically, the states and the federal government have employed certain devices to deal with mutual problems in the intergovernmental field. Such devices have been described as "short circuits"[4] in that they provide a direct contact between structurally separate portions and levels of the governmental system. Notable among these devices are interstate compacts, which came into use early in the history

[3] 60 Sup. Ct. 504, February 12, 1940.

[4] Garland C. Routt, "Interstate Compacts and Administrative Cooperation," *The Annals*, CCVII (1940), 93.

of American governmental system. Other measures coordinating, to some degree, state and federal action include grants-in-aid, interstate crime commissions, and various types of voluntary regional control of water resources.[5]

Interstate Cooperation

In response to the need for improved methods applicable in the field of intergovernmental relationships, the Council of State Governments was formed in 1925. The growth of the Council, as indicated by its revised program and widened scope of activities, is an index of the need for machinery to provide for more efficient cooperation between state governments. The program of the Council has been planned to foster the successful operation of the present democratic form of American government. Actually, the Council is the secretariat of the Governors' Conference, the National Association of Attorneys General, and the National Association of Secretaries of State. The Council acts as a clearing house and a research center not only for those organizations but also for state legislators and legislative reference bureaus. The Council is the means through which joint federal-state and interstate problems are being solved. These problems originate in various fields, such as questions of flood control, stream pollution, highway safety, interstate truck regulations, social security, liquor control, and others.

The functioning agents of the Council in this respect are the Commissions on Interstate Cooperation[6] which have been created by each of the 44 states now composing the Council. These Commissions assume the initiative in matters of interstate or inter-regional conflict and have achieved

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[5] David W. Robinson, "Voluntary Regionalism in the Control of Water Resources," *The Annals*, CCVII (1940), 116.

[6] The Council of State Governments, *The Book of the States, 1939-40*, pp. 9-13.

progress in eliminating many types of trade barriers. Thus have the states provided, in part, the machinery believed to be adaptable for the adequate solution of the trade-barrier problem.

Much popular attention has already been focussed on trade barriers. Educational publicity has been fairly widespread. National conferences and regional meetings have taken place. Many trade associations, civic and professional groups, both national and local, have taken a stand condemning this manifestation of the doctrine of internal economic protectionism.

Since it is a fact that the majority of interstate trade-barrier laws are creations of the states and since they may be repealed by the states, consideration should be given to plans which would vitalize any latent remedial state legislative impulse.

Federal-State Cooperation

Officials of the federal government, broadly speaking, are of the opinion, now, that joint action by all levels of government involved is required as a general approach to the solution of the trade-barrier question. Accordingly, the United States Department of Commerce, in November, 1939, in cooperation with nine other agencies of the federal government, established the Interdepartmental Committee on Interstate Trade Barriers. It is perhaps sufficient to state here that the activities of this committee have been directed towards developing additional pertinent trade-barrier information, and towards cooperating with the states, through the Council of State Governments, in various phases of an anti-trade barrier program, including the settlement of specific trade-barrier cases.

In an address before the Conference on Western Govern-

mental Problems, former Secretary of Agriculture Wallace gave further endorsement to the principle of joint federal-state approach when he stated:

> A third approach would call for joint action by state and federal governments, each within its proper sphere, yet plainly and by design supplementing and reinforcing each other. It seems to me this approach offers the most hope, though I do not discount the possibility of federal action by itself, under certain conditions, or of state action by itself, when this is feasible.[7]

In this address, former Secretary Wallace discarded, as being less practical, two other avenues of approach, namely, one, that the federal government could exercise more of the power given it by the Constitution to regulate commerce between the states and, two, that of the opposite extreme of leaving the solution of the problem wholly to the states. It is further interesting to note that a number of the witnesses appearing before the Temporary National Economic Committee at the hearing on interstate trade barriers held in Washington in March of this year took the view that a joint federal-state approach to the problem was the most reasonable approach and the one most likely to succeed.

Survey of Existing Federal Legislation Permitting Administrative Action with Respect to Trade Barriers

Immediately following the trade-barrier hearings, the Interdepartmental Committee on Interstate Trade Barriers felt that, before attempting to work out the detail of any joint federal-state approach to the trade-barrier question and before the proper recommendations could be made to Congress, an examination of the present body of federal law should be made in order to determine a reasonable course

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[7] Henry A. Wallace, "The Federal Government and Internal Trade Barriers," San Francisco, October 26, 1939.

of future legislative revision. Therefore, in May, 1940, the Interdepartmental Committee announced the formation of a Legal Subcommittee[8] which was asked to undertake two legal studies, namely, (1) to examine federal legislation in order to discover hitherto unused administrative powers to combat interstate trade barriers, and (2) to outline new federal legislation which could be constitutionally enacted to combat interstate trade barriers. Part I of the assignment of the Legal Subcommittee has been completed, and the findings are herewith summarized as indicating the extent to which the constitutional powers of the federal government to deal with this subject have already been implemented.

The Legal Subcommittee has briefly summarized its conclusion under the following ten divisions:

1. *Persuasive Action.*—Through the cooperative action of interested federal agencies, the Interdepartmental Committee on Interstate Trade Barriers and the Council of State Governments, considerable persuasive pressure could be exerted in forestalling the enactment of trade-barrier legislation and in combatting trade-barrier legislation which has been enacted.

2. *Measures Designed to Correct Restraint of Trade Practices.*—State and local laws may, on their faces, constitute a restraint on interstate trade, or they may sanction administrative action which can be used to this end. Also, state or municipal offices may act *ulta vires* to suppress or restrain interstate commerce. The filing of briefs *amicus curiae*, by the Department of Justice, injunction suits under the theory of the *Debs* case, and anti-trust prosecutions are techniques which may be effective in combatting these restraint-of-trade practices.

3. *Litigation Designed to Clarify the Concept of Interstate Com-*

[8] Haskell Donoho, U. S. Department of Agriculture, Chairman of the Legal Subcommittee. Members: Guerra Everett, U. S. Department of Commerce; John E. O'Neill, Treasury; Edwin G. Martin, Tariff Commission; Walter F. Young, WPA; C. Edward Rhetts, Labor; Kurt Borchardt, Justice; Corwin D. Edwards, Justice; Howard Fedderson, Consumers' Counsel, Dept. of Agriculture; R. W. Snow, Interstate Commerce Commission; A. C. Phelps, Federal Trade Commission; and Paul T. Truitt, Commerce.

merce.—A concerted policy, on the part of federal agencies, of bringing cases before the United States Supreme Court which would clarify and possibly broaden the existing judicial concept of interstate commerce, might materially aid litigants who are burdened by trade-restricting state laws.

4. *Investigation by the Federal Trade Commission.*—The Federal Trade Commission is empowered to undertake an investigation of interstate trade-barrier problems.

5. *Uniform State Laws.*—The Interdepartmental Committee on Interstate Trade Barriers might effectively assist in advancing this type of administrative action. A uniform seed law is now being prepared by the Department of Agriculture, and the standard milk ordinance of the Public Health Service has been adopted by many communities.

And may I pause here to take note of the fifty-year record of achievement in the field of promoting uniform state laws just completed by the National Conference of Commissioners on Uniform State Laws. This Conference has brought about the adoption of approximately six hundred acts by which conflicts between various laws of the 48 states were reduced or eliminated. As the Corning, New York, *Leader* wisely said, "There is more work for the commissioners to do . . . it is possible that 600 more will come in the future and that these 'United' States will manage to retain their individuality and sovereignty and yet cooperate in matters in which uniformity would be a blessing to all concerned."[9]

6. *Public Health Service.*—The Surgeon General may call special conferences of state health boards and of state health officers.

7. *Federal Food, Drug and Cosmetic Act.*—Under the Federal Food, Drug and Cosmetic Act, the existence of trade barriers with respect to any commodity might well be taken under consideration in prescribing regulations. In this connection, reference is made to state labeling laws, to state laws specifying sizes of containers, and to state laws governing the quality of milk and cream. Moreover, it is believed that administrative action publicizing the situations in which barriers to interstate shipments have developed in this field might be possible under the Federal Food, Drug and Cosmetic Act.

[9] *State Government,* XIII (1940), 236.

8. *Regulations Pursuant to the Agricultural Marketing Agreement Act of 1937.*—Under the Agricultural Marketing Agreement Act of 1937, it is believed that the Secretary of Agriculture has discretion in setting up administrative conditions precedent to needed federal cooperative action sufficient to require that state regulations relative to state marketing agreements with respect to milk and its products be promulgated with a view toward eliminating trade barriers.

9. *Federal Grants-In-Aid.*—As a general proposition, it would seem that whenever a specific trade barrier exists in the states, the operation of which materially interferes with or hampers a project financed in whole or in part by federal funds, those administering the expenditure of such funds may attach conditions to the granting of these funds that will operate to remove the objectionable trade barrier.

10. *Regulations Implementing Quarantine Legislation.*—Under Section 3 of the Animal Industry Act, the Secretary of Agriculture is authorized to cooperate in execution and enforcement of provisions of the act working toward the suppression of dangerous, contagious, infectious, and communicable animal diseases.

A more detailed exposition of these points may be had upon application to the Interdepartmental Committee.

New Federal Legislation to Combat Trade Barriers

The Legal Subcommittee is now engaged in a study of Part II of its assignment and it is hoped that the results of this study may be made public during the first quarter of 1941.

In view of the many current practical aspects of the trade-barrier question (such as the great diversity of climatic, geographic, and political conditions, the non-uniformity of state laws as between the states themselves, the non-uniformity between state and federal law on a given subject, and the lack of a systematic program for fixing the limits of state and national control over interstate commerce), and because of administrative difficulties inherent in the centralization of regulation over multitudinous commercial activities, which legally are within the purview of the commerce power of the federal government, many phases of

commercial activity may best be regulated by the states, *providing* such regulatory law is in harmony with state and federal requirements and is fairly applicable to both inter- and intrastate commerce.

Joint Federal-State Committee

It is thought that the most practical suggestion for achieving this goal which has been made thus far is the proposal made by the Council of State Governments to establish a joint federal-state committee composed of representatives of the federal government and of the state governments. This proposal was made by Frank Bane, Executive Director of the Council of State Governments, at the trade-barrier hearing before the Temporary National Economic Committee and is now being studied by that committee. The function of such a committee would include the placing of its research facilities and the prestige incident to its well-considered recommendations at the disposal of federal and state governments and other organizations and persons who are now seeking to curb unfair discriminatory state legislation of a localistic commercial nature. Further, this committee would, in the best interests of the states and the nation, after exhaustive study, determine and recommend as a matter of policy the proper limits of federal regulation which should obtain in the commerce field. It is recognized that in the extremely complicated field of commercial regulation, because of its relationship to individual livelihood, legislation affecting such should obviously be enacted only after a thorough study of all interests involved. To make such a study satisfactorily would require the collective experience and guidance of a committee representing both the federal government and the states. This committee would require funds, authority, and facilities for conducting de-

tailed research and for making detailed and constructive recommendations jointly to appropriate state and federal legislative bodies. Precedent for such a committee is found in the Temporary National Economic Committee created by Congress in 1938 with specific powers to do a specific job.

It has been recommended to the Temporary National Economic Committee that the proposed federal-state committee be composed of 12 members, with representation divided equally between the Congress of the United States, the executive branch of the federal government, and the states represented through the Council of State Governments. More specifically, it is proposed that the Senate and the House of Representatives should each have two representatives on the committee. The executive branch of the federal government possibly should be represented by four members to be appointed respectively by the heads of the Departments of Agriculture and Commerce, the Interstate Commerce Commission, and the Federal Works Agency. The states possibly should be represented by four persons, one to be appointed by the Council of State Governments from each of the four major geographical areas of the country. Such a division of membership, it is believed, would give equal representation to the states and to the federal government, since the Congressional members represent a point of view both of the states and the federal government, and in that sense these members should prove an excellent balance wheel between possible divergent points of view between the executive branch of the federal government and the states. Thus would cooperation among the states and with the federal government be encouraged, and the wise limits of federal and state action would be recommended.

Besides being of practical value in the reasonably imme-

diate solution of the troublesome trade-barrier problem, it is further probable that the creation of a joint federal-state committee would prove a strengthening influence in our present democratic form of government. Totalitarianism is the twentieth century threat to democracy, and the life-blood of totalitarianism is centralization of power in the hands of the national government. In order more effectively to resist this now almost world-wide epidemic of totalitarianism, we must preserve the great free internal American market which has contributed so largely to the unparalleled American standard of living. We must work to facilitate economic growth and progress by promoting a freer exchange of goods and services between the various sections of this country. In fact, a greater degree of uniformity between states in state law and with federal law would not in any sense weaken or compromise state sovereignty. On the other hand, such action would strengthen state sovereignty by removing factors which later might become cause for more sweeping commercial regulatory action on the part of the federal government. It is important that this nation, now, begin to develop a type of joint federal-state commercial regulation which will establish free trade among the states in reality and not merely as an academic economic theory.

CHAPTER XXIX

THE RELATION BETWEEN HIGH CONSUMER TAXES AND INTERSTATE TRADE BARRIERS

F. Eugene Melder

Department of Economics and Sociology, Clark University

There has been a tendency among students of economic and governmental policy to line themselves up in two camps from which the members of each heap invective and other emotional language upon the members of the opposite camp. Each group pretends to maintain a rigorous and objective point of view, untainted with mere ethical considerations. The spokesmen for each camp put forth the claim that its members and its members alone are in possession of the truth, or have the broader public point of view at heart, or some similar claim. On the other hand, by inference or outright accusation, all those who do not agree with the group's views are prejudiced, immoral, or a menace to society. Many notable examples from the history of economic ideas could be cited. To cite but one, I would like to call attention to the long controversy between the free trade and protectionist schools of economic thought.

I want to make it clear at the start that I am a prejudiced human being, that I know it, and probably that I am a propagandist. I am a firm believer in an economic religion which I shall call the "high standard of living" creed. I have a definite bias in economics and politics in that I believe that the real purpose of political and economic activity should be to produce social order and goods and services

for the use of human beings. I, for one, do not believe that government can be an end in itself, nor that we can successfully operate an economic system on the theory that the ultimate end of production is to benefit the producer, either by creating artificial scarcity, eliminating honest competition, or preventing the reduction of prices through various schemes for prohibiting the introduction of improved production methods.

Effects of Modern Technology Upon World Economy

Having stated my biases, I take the liberty of citing a few facts in order to provide some perspective for my remarks. The first of these facts I hardly need to mention, as it has been brought out again and again by recent events. I shall state it, however, to be certain that it is clearly understood. We live in a period of history when the rate of change in the world is almost without precedent. I have in mind, particularly, the rapid technological changes which we popularly call the industrial revolution. It affects everyone to some degree, but it is even more influential in America than in most other countries. It represents a revolution in the means and methods of production, transportation, communication, and even in methods of warfare. The only unique thing about the "blitzkrieg," of which we have heard so much in recent months, is that the technology of the industrial revolution has finally been applied on a wholesale scale to the war purposes of destruction and conquest.

The fact of the industrial revolution leads to a second fact—namely, the world has grown interdependent, whether we like it or not, as a result of the industrial revolution. In the past century and a half we have developed a world-economy, in which the economic welfare of each sector is dependent in some degree on the economic goods produced

in all other sectors. To trace the history of this growing interdependence would be to describe man's gradual conquest of an almost infinite number of natural barriers to human intercourse—his feats of mastering the water hazards of oceans, rivers, and lakes by the arts of navigation and communication, by bridges, by boats, telegraph cable, radio, and the airplane. It would be the story of the overcoming of the topographical barriers of mountains and deserts, forest and plain, and communication barriers of space, by means of road, and railroad, canal and airport. The very water and space barriers have become the marine highways of commerce and the air highways of the airplane and radio waves. As a result, man has cut and cut again the cost of transportation, and the time required for travel, transport, and communication.

Each new success made possible widened markets for man's goods by giving more value for the consumer's dollar and increased the economic interdependence of the various parts of the world. Today, we daily consume commodities that have come from the ends of the world. The modern automobile could not be produced without the rubber of the tropics and fifty or more other essential imported commodities such as non-ferrous metals for alloy steels.[1] The trend has been constantly toward a world-economy and a greater amount of consumable goods for the labor and capital expended—no matter what the price level has been. The early steps were slow, but in the last century the pace has been more rapid. The natural barriers of the world have shrunk so rapidly of late that today we verily could hear on our radios the voice of Mr. Churchill addressing the House of Commons before the sound waves could carry it to the ears of the Members of Parliament themselves.

[1] Cf. Gardner Harding, *Foreign Trade, Our Magic Carpet,* pp. 6-9.

This technological economic interdependence of the world is of profound significance to politics as well as to economics. It means that the goods and services needed by man cannot be produced any longer within the political boundaries of his local or national community. It means that political autonomy is obsolete, so far as technology is concerned. It means that no great political upheavals or economic disasters can be localized. Whether we like it or not, we belong to an international economic brotherhood of man, although, as individuals, we may think of ourselves only as Americans.

Now, such an economy creates great problems, as well as offering wonderful possibilities for the betterment of the plane or standard of living of all men. For the first time in history, man has caught a glimpse of a really possible Utopia, or land of plenty. But such a Utopia has its prices. One of these prices is the reorganization of former local economic units to supply wider markets. Another price consists of increased competition within any given market. The grain farmer no longer sells in a local market, but sells in a world market. He is competing with other grain growers in every continent. This fact means several things, one of which is that he is dependent for prosperity not only upon favorable weather conditions for his growing crops and a good local demand but also upon the climatic factors of the Argentine, shipping costs, unimpaired trade channels, transportation changes, and a thousand other things over which he has no control and often cannot even understand. In other words, he must sell in a highly unstable market. This illustrates a very important point in my argument. It is this: modern technology has given us a world-economy—world markets, rising living standards, and economic interdependence at the price of increased economic instability. Our economy resembles a complicated but delicate machine,

of which the failure or weakening of any part tends to slow up the efficiency of the whole. Thus, depressions and hard times no longer are local; no longer do they arise chiefly out of national or natural causes such as crop failure and drought. When the Credit-Anstalt Bank failed in Austria, it started a chain of events which seriously shook the economic structure of the entire world in 1931, and ultimately forced most of the nations off the gold standard. We find we are living in a world economy of great instability; at the same time technology has given us the possibility of an economy of plenty.[2]

Bearing in mind these facts, it is easy to understand man's quest for security. One of man's greatest and most constant goals is security. Just as he always has worked for a more plentiful supply of the goods he lives on, so he has always sought stability and security. In more primitive days these goals were not incompatible. But, today it may well be questioned whether technology, in destroying the barriers of space and poverty, has not created an insecurity which man cannot solve within his present political order. Probably this is a question that no man can finally answer—and, therefore, I shall not attempt to.

International Tariff Barriers

As our ancestors, however, gradually overcame the natural barriers to travel and trade, they soon set about creating artificial barriers in the form of protective tariffs, navigation laws, embargoes, and a dozen other varieties of human devices. Recently, I had occasion to do some reading in tariff history, and I was amazed to discover that increased political barriers to trade and travel have accompanied almost every step technology has made toward reducing the natural

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[2] Cf. Eugene Staley, *World Economy in Transition,* pp. 3-35.

barriers of geography. Throughout the whole of modern history, these tax barriers and other monopolistic devices have been employed to prevent the realization of a free market.[3] It is true that the methods have changed somewhat and the purposes have varied, but as economic interdependence and market instability have increased, trade barriers to prevent the free flow of goods to consumers have been almost universal.

Historically, tariff barriers as we recognize them today seem to have accompanied into existence the strong nation states which developed in Europe with the decay of feudalism. This early period is known in history as the era of mercantilism. I found it a point of great interest that the early embargoes, customs duties, and navigation laws were enacted for the principal purpose of building up strong military states. The monarchs who created them thought that to be strong a nation must have great stores of gold, as gold could purchase anything, even victory in war. In order to get this treasure they set out to encourage exports and decrease imports, other than gold. Trade regulations served this purpose with few exceptions. High taxes were levied on consumer goods to discourage their import and prevent trade in them. We can conclude, then, that the relation between high consumer taxes and the early national trade barriers was a close one. In fact, it may be safe to say that mercantilistic trade barriers were largely nothing but high taxes levied ultimately on the consumer to prevent him from consuming imported commodities.

With the beginning of the industrial revolution, however, national tariff barriers began to change; at least, their purpose changed. As manufacturing began to be an important

[3] Cf. Jacob Viner, "Tariff," *Encyclopedia of the Social Sciences,* XIV, pp. 514-22.

source of wealth production, new economic pressure groups came into being. Soon every nation which possessed groups with aspirations to cultivate manufacturing began to levy protective tariffs and to create similar trade barriers, in order to protect the market of home producers from the full force of international economic competition.

This was the period when the natural barriers to trade and commerce were beginning to be reduced at a rapidly increasing rate. Producer groups readily saw the economic advantage to themselves of staking out home markets. Trade barriers served their purposes admirably. Their arguments were tempting. They went something like this: "We want a prosperous nation; it will help the laborer, the farmer, and the nation to prosperity if we buy less abroad and more at home. Therefore, let us put high taxes on the consumers who buy the products other nations can produce cheaper than we can, and thus make them buy at home." In this manner the purpose of trade barriers was shifted from the end of promoting the strong state to that of protecting various domestic economic groups in the enjoyment of favorable conditions in their home markets, freed to a large degree from foreign competition.

A certain amount of security was purchased for special producer groups at the expense of the consuming public, for it is true that the consumer pays the bills for such taxes in the long run, however disguised or unrecognized the taxes may be. Again we see the principle that economic security is purchased at the price of a reduced standard of living. Consumers cannot consume as many goods when prices are raised, whether they are raised by privately created monopolies or by publicly levied tax barriers.

National protective tariffs tend to benefit special interest groups, at least temporarily, by pegging the price structure,

and to hurt the consumer indirectly by widening the gap between production costs and consumer prices. The ultimate or long-run effect, in the sense of who gains, is not so clear, because such things as encouraging relatively inefficient methods of production, the elasticity of supply, elasticity of demand, and other factors would have to be considered by complex theoretical and statistical studies to get answers for every specific consumer tax. It is safe to generalize further, however, that man-made barriers, like the natural barriers they have tended to replace, interfere with trade in such a way as to create artificial scarcity to replace natural scarcity, and to prevent adjustments in our international economy to utilize the relative natural productive advantages of various parts of the world.[4]

Since the World War, and particularly since 1930, national trade barriers have increased in variety, and the main purpose has been changed once more. Many nations, following the example of Italy and Germany, have made extensive use of many types of trade restrictions, including some types of controls not previously utilized, in order to gird themselves for war. Like the mercantilists of the sixteenth and seventeenth centuries, they think of trade barriers as tools to create strong military states. Unlike those early nationalists, the modern method of building a strong military state becomes the creation of economies of "autarchy" or self-sufficiency rather than the acquisition of a maximum store of gold. Only in the United States have modern trade barriers had the effect of promoting the accumulation of precious metals. But that is a story I need not go into further here. Hermann Goering's remark that

[4] For an early but excellent statement of the consequences of protective trade barriers, *consult* Frederic Bastiat, *Economic Sophisms,* originally published in two series in 1845 and 1848, respectively, in France. An excellent English translation is that of Patrick James Stirling.

Germany will have "guns instead of butter" illustrates perfectly the results of this type of trade barrier, so far as the consumer is concerned. Modern Fascist trade regulation means exactly that—"guns instead of butter." Again the consumer—meaning everyone—gets it in the neck.

State and Local Trade Walls

But, to return to tax barriers and the consumer, let us turn to the states and trade barriers we have heard discussed in this symposium. I think we can generalize from our discussions that, like the national tariffs of the period of history of the industrial revolution, these state and local trade walls have grown up in a national market where modern transportation and machine methods have largely erased the natural barriers to marketing. The states, consciously or unconsciously, have been busy protecting certain groups of their producers from the competitive effects such changes make possible. We have seen that these state and local restrictions have arisen, very frequently, in attempts to capture economic security in a world that is changing so rapidly that almost everyone feels he is suffering from the threat of insecurity. More specifically, these barriers have arisen from four main causes.

First, they provide protection and market security for home producer and merchant groups by preventing consumers from buying goods imported from sister states and by discouraging the growth of more efficient marketing channels or organizations which sell at lower prices to the consumer, such as chain stores.

Secondly, these measures frequently owe their existence to attempts by states to retaliate against real or fancied injuries done to their citizens by sister states. Albert Lepawsky of the Federation of Tax Administrators has character-

ized these laws most effectively when he calls them the product of "backyard quarrels" rather than acts of statecraft.[5]

A *third* important source of interstate tax barriers is the pressure for new sources of public revenue to meet increased financial burdens in recent years, or to replace old revenue sources which are proving inadequate. For example, this pressure, plus the desires of special groups for tax relief, led many states to the adoption of the retail sales and various other consumer taxes in order to relieve tax pressure on other groups. Such taxes immediately gave some consumers a motive to purchase across state lines to avoid these taxes. Hence, state legislators and merchants set out to devise ways and means to keep these consumers' purchases at home, and the use tax, for example, is the result. In other words, the state in its insecurity of tax income, itself adopts trade-barrier tax measures, to catch the ever wary consumer. It is argued that a sales tax places domestic concerns at a disadvantage with outside competitors in neighboring states which do not have such a tax and that the outsiders thus tend to dominate the state's markets. On the other hand, the fact that out-of-state competitors may pay other taxes, as heavy or heavier than a sales tax, is largely ignored.[6]

These taxes seem to lead around a vicious circle. The circle seems to be as follows: Unstable economic conditions cause state revenue sources to dry up and, at the same time, cause state functions to be expanded. The states then tax consumers with high consumer taxes, which encourage consumers to seek means of evasion or force curtailment of their purchases. Then the states must tax again to prevent eva-

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[5] *Proceedings of the National Tax Association, 1939,* p. 394.

[6] A. G. Buehler, "Sales Taxes," *Encyclopedia of the Social Sciences,* XIII, p. 517.

sion and to protect their revenues, with the result that the free flow of goods in interstate commerce tends to be impeded, it becomes more difficult to do business, and business conditions tend to become more unstable, as larger portions of consumer purchasing power are drained off in regressive forms of taxation. The circle is completed in that unstable business conditions arise from state attempts to increase stability of revenues.

Unfortunately, no one has yet demonstrated, so far as I know, the relationship between regressive taxes and stability, or rather, instability of economic conditions. Professor Henry C. Simons, in his little book *Personal Income Taxation,* has made some interesting suggestions along this line, in his approach to government fiscal policy. Professor Harold Groves, as well as other economists, has long advocated tax policy revisions which would produce increased federal revenues without such unstabilizing tendencies.

But to get back to sources of trade barriers, the *fourth* specific source of interstate trade barriers which I wish to mention is largely outside the field of taxation. It arises out of the fact of dual sovereignty in our federal system of government. This system is productive of trade barriers in situations where state regulation of transportation and trade, such as state grades and standards and highway regulations, imposes unique rules long after the technology of transportation has erased the natural barriers of the state, to make its market area part of a wider national market. When a state keeps these obsolete regulations after the conditions which called them into existence have passed, it may impose a considerable trade barrier, because its standards do not comply with federal standards.[7] Consumers suffer, not

[7] Cf. Taylor, Burtis and Waugh, *Barriers to Internal Trade in Farm Products,* pp. 68-84.

because of market protective taxation in such instances, but because they are deprived of useful products produced in other sections where natural conditions are advantageous or methods of production are more efficient, and forced to consume local products produced at higher cost, due to quirks of state law. Somewhat the same thing applies when technology makes possible economical transport for increased distances of perishable products such as milk, but consumers are deprived of these products by the refusal of the "sovereign" milk inspectors of the local milk shed to accept the inspection reports of the health officials of another jurisdiction.

Trade Barriers and the Consumer

I believe we have had examined at this symposium enough international and state tax barriers, as well as other kinds of barriers, in their relation to the consumer, to draw a few conclusions. I think it can be said, with great validity, that such measures restrict consumption and check rising standards of living, intentionally or unintentionally as the case may be. They have come into existence largely through the attempts of state and national governments to erect artificial barriers to replace natural barriers to trade and plenty or through state failure to remove obsolete trade and health regulations as a market expands. The natural hindrances to free exchange of goods are no longer effective, due to the rapid strides of technology and the industrial revolution. In creating these barriers, states and nations are seeking to obtain security for various private minority business and special interest groups, at the expense of the welfare of the wider groups of the consuming population.

Adam Smith's dictum is pertinent in this connection. Division of labor (specialization) is limited by the extent of

the market.[8] Tax barriers which artificially narrow the market prevent the efficiencies of regional specialization. This seems to occur in large measure because these private groups consider that preservation of scarcity values is the way to their security. Governments and populations fail to recognize that the economic justification of private business activity is that it may supply the consuming population more efficiently and with a greater abundance of goods and services than can a publicly operated economic system. If private enterprise does not provide a system of production and distribution which fully utilizes modern technology to supply men's wants with the promises of a rising standard of living but, instead, always must get government help to create artificial scarcity barriers to prevent abundance and efficiency, then I fear private enterprise or capitalism is on the way out.

There are signposts aplenty to indicate that we must voluntarily overhaul our political institutions or change our economic organization toward the achievement of a more abundant life for the consumers as a whole, or we will have it done for us by men whose ruthlessness enables them to make a sham out of the values of democracy and freedom we treasure and cherish. We have witnessed changes in the past 10 years which cause us to be aghast with uncertainty and fear. If I were a reader of events in crystal balls, perhaps I could predict where the changes of the coming decades will leave us. Since I am not, I hardly venture to guess. On the basis of statistical probability, I suspect that we will have moved a long way from where we are today. We may have learned to stabilize private capitalism, to control the business cycle. We may have socialized some of the great basic industries. We may have turned to "autarchy" our-

[8] Adam Smith, *The Wealth of Nations,* Book I, Chapter 3.

selves, as offering the most promising hope of security and plenty, in a world gone crazy with nationalism—in a world-economic society which, to be prosperous, must learn to operate in an international economic order.

All the possibilities before the United States in the near future appear to be grim choices. It seems to me that the grimmest of all would be to lay ourselves open to successful attack either by invader or internal *revolutionnaire*. One way we might do this is by making ourselves economically weak through allowing our psychological and economic unity to be undermined by the practice of state market protectionism and the cultivation of the belief that we can achieve security by breaking our national market up into segments suitable to protect our state and local special interest groups.

Every hope we have for democracy and the future of that indefinable ideal which we call the American Way lies in the direction of making our political and economic structure operate most efficiently, so as to give a more abundant life and a sense of importance and opportunity to the individual. Certainly little hope for the future is to be entertained in the creation of artificial scarcity which will penalize the consuming masses in order to protect the security of the special interest minorities.

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